

IMPACT OF MICROFINANCING ON REDUCING POVERTY IN DEVELOPING COUNTRIES, CASE JORDAN.

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Abstract

More than half of human population in developing countries lack access to financial services from institutions, either for credit or for savings. Providing the poor with access to financial service is one of the ways to increase their incomes and productivity, therefore reducing poverty from the basic point of view (Robinson, 2001). Poverty in developing countries is resulting from different impacts such as low economic growth, high population growth, unequal distribution of resources, diseases etc. Therefore it causes low productivity and unemployment of the poor. To increase the productivity of the poor by creating employment means to improve access to financial services in developing countries. In many low-income countries there is more than 70 percent of the people working in agriculture. This mostly self-employment of the poor causes rural poverty in the case of seasonal agriculture or natural disaster. Therefore also lack of savings and capital is a big problem for poor people in developing countries. Providing a credit seems to be a way to generate self-employment opportunities for the poor. And the successful way to bring it into effect is microfinance.

Key words: microfinance, microcredit, access to financial services, poverty, developing countries

INTRODUCTION

More than half of human population has no access to financial services. At present there is big competition among providers of financial services all around us. Banks still offer new and new products to win customers. Lending money still bring a profit by way of interests for bank so how is possible that there are so many people with a lack of financial services in developing countries.

First basic reason is possible to find in a policy of banks – banks can't profit from somebody who regards few dollars as a fortune. Simply because banks generally assume that providing small loans and deposit services would be unprofitable. It is a question but let say this opinion has been generally received by banks.

Then there is a question of location of banks. For many poor people living in the villages is just the long distance to the bank one of biggest problem in issue of financial services.

Certain importance is also possible to add to distrust and fear of low-educated people from process relating to taking a loan etc. And of course guarantee required by the bank can't be forgotten as one of the most important determinants of lack of financial services.

For those poor people in developing countries who would like to take a loan and start their own little business but they can't reach the classic loans, there is another way to reach it – microcredit.

Microcredit is the name given to small loans made to poor people who are regarded as bad financial risk, by conventional banks, as they have insufficient savings or assets to obtain a loan. Despite the diversity of definitions the world microcredit generally means:

- small size loans
- shorter repayment periods
- flexible and easy to understand regulations

and loans

- small scale activities based on local conditions and needs
- clients and small entrepreneurs and low-income households
- loans used to generate income, develop enterprises and used by the community for social services such as health and education (Bliss, 2005)

Microcredits are provided by Microfinance Institutions. They can be formal, semiformal or informal. However, providing credit to the poor is often considered risky, the number of MFIs in developing countries is still increasing. Microfinance, as an integral part of financial market, is still developing. The present trend is transformation of the informal untransparent MFI which are often non profit, social motivated, co-operative or depended on donors to the formal transparent MFIs which are profit and sustainable. Though it is considerable that in some areas the informal MFIs will stay the main financial help to the local poor people.

For a variety of reasons – such as the problems of imperfect information and imperfect enforcement, covariate risk of agricultural production, and political interference – many countries find it difficult to develop sustainable rural financial institutions. However, the recent experience of microcredit and rural credit programs in several countries suggest that sustainable financial institution may be possible to develop in a rural setting if certain conditions are met:

- the government does not see financial institutions as a public transfer mechanism or interfere with them in any way except to provide prudent regulation and supervision
- financial institutions are allowed to set interest rates that reflect market forces and adjust with inflation rates

- financial intermediation that includes savings mobilization is an integral part of credit delivery to targeted sectors or groups, so that targeted programs learn to depend on markets rather than solely on donors for funding
- loan contracts are enforced through social and economic incentives or other means such as group pressure
- grants or subsidised funds are given as seed capital for a limited period of time to support institutional development. (Khandker, 1998)

There are many countries supporting microfinancing which is using as an antipoverty tool because it helps to decrease unemployment, thereby increasing income connected with consumption and therefore reducing poverty. In mostly Islamic countries can microfinancing improve the situation not just for the poorest but also for the women generally. Therefore many MFIs provide special programs for women.

MATERIAL AND METHODS

Data for case study in Jordan were picked up during the research stay in Jordan in summer 2006. Most of information proceed from interviews and consultations with experts in relevant institutions (MFIs in Jordan, experts in Microfinance, the private sector, clients of MFIs) especially in region of Karak. Information about various MFIs in Jordan were also gathered from internal materials and presentations of MFIs.

The background for the part - Rotational systems- was gathered from interviews with heads of informal MFIs in the area close the Dead Sea (Ghorsafi).

RESULTS AND DISCUSSION

Case study in Jordan

One of the Islamic countries where microfinancing is wide-spread is Jordan. There are many MFI formal such as informal. Islamic countries have to face to some specialities resulting from the religion. One of them is the fact that lending money is prohibited for Muslims according to the religion rules. Therefore there is a lack of taking a classical loan for radical Muslims.

MFI in Jordan are offering special approach for this people. For example National Microfinance bank works on the principle called "MURABEHA". "MURABEHA" is the principle of granting credit. Because of religion impact in Jordan lending money is prohibited for Muslims. Therefore there is another possibility to take a credit for radical Muslims. Those people can buy a goods by invoice and the bank pay directly to the shop. So there is no infraction against the Islamic rules.

National Microfinance bank is a Jordanian private share-holding non-profit company, dedicated solely to the delivery of sustainable financial services to micro and small entrepreneurs in Jordan, particularly woman. National Microfinance bank was established in March 2006 and during the first four month has provided its

services for more than 5000 clients and this number is still increasing. Discounting the fact of high interest in microfinancing generally in Jordan the success results from understanding of needs of the people.

According to the survey made in 2006 in Jordan the most important reasons for taking microfinance loans are:

- 1) short period for receiving money with the guarantee most highly 2 weeks whereas in commercial banks is it around 2 months
- 2) issue of loan size
- 3) lack of guarantee
- 4) term of expiration
- 5) interests

According to this research the focus is putted on loan size, guarantee and process of money lending.

The next issue in the research was related to the question: Where do you prefer to take a loan?

Here is the resulting sequence:

microfinance bank

Islamic bank

commercial bank

People were also asked for the reason of their preference, if they have ever taken a loan in a commercial bank and in case of answering NO, why?

Here are the most frequently answers:

- worry about complicated process of lending money
- religious reasons
- disagreeable
- higher interests
- loan size

All this aspects make than the MFIs create services better available to people. For example guarantee required in commercial bank means lack of financial services for most of the poor. What the MFIs do offer for improving access to the financial services? There are different ways of guarantee in various MFIs. Mostly there are no guarantee required, usual just the fact that the client can get arrested while defaulting (according to the religions is it for Muslim impossible). Some MFIs use just confidence in the client as a tool of guarantee (e.g. Middle East Micro Credit Company).

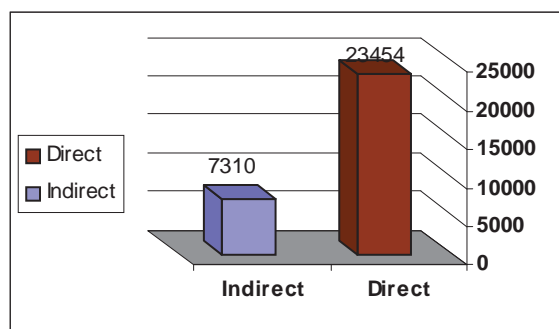
Of course there are some conditions which have to be fulfilled for taking a microcredit. For example for Development and Employment Fund (Fig. 1) is necessary condition presentation of project by people asking for a loan. Therefore lending money by DEF are connected just with improving employment in the area and development of business. Every applicant for loan is also valued according to Credit Scoring System (Tab.1). If there is a project which is beneficial for whole area than there is possible to take a bigger loan. All projects are under screening control. In case that money are used for another function than for project than the interest rises from 5% up to 10%.

Between (1991-1/6/2006) DEF total lending amounted to JD (75,2) million to finance more than 30700

projects, created 36984 seasonal and permanent job opportunities.(DEF presentation, 2006)
This number is still increasing. This fact reflects the growing interest in microcredit.

Lending Operations (1991-1/6/2006)

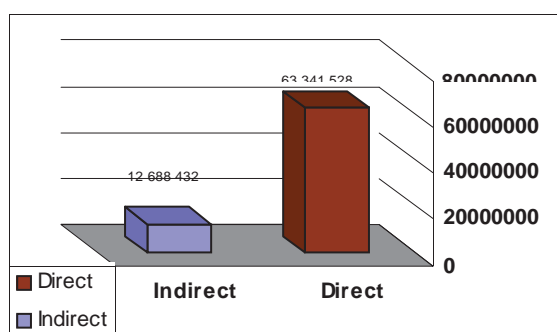
No. of Projects



Source: presentation of DEF, 2006

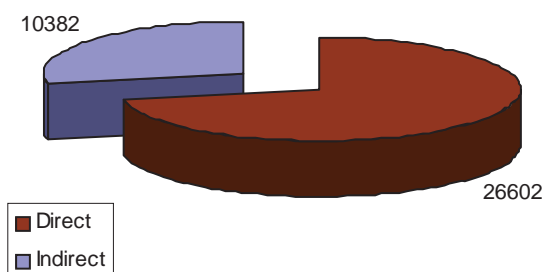
Value of Loans

(JD)



Source: presentation of DEF, 2006

No. of job opportunity



Note: Direct means lending money direct to the people in the area.

Indirect means lending money to other organisations in the areas where are no DEF branches.

According to the latest survey more than (67.2%) of the

projects financed directly from DEF during 1991-2004 still operating. (DEF presentation, 2006)

Every project is supervised to know if the money is used the right way for project. IRADA- one of the supervising organization- provide together with supervising also supporting beneficiaries by giving informations, making orientations and workshops. IRADA send a training expert in the areas where needed. For example in Rakin (area close to Dead Sea) there produce local people rubber kids toys thanks the project. Because this people didn't have many experiences in this field, IRADA has arranged for the seminar to improve skills of local people for higher productivity. An Expert has taught those people how to manufacture efficiently the rubber.

All this activities are very useful for helping people increase their income and therefore to improve their living standard.

Rotational systems

Through all that facts there are areas where no financial organizations are available for local people. This people used to help each other by rotational system of lending money. This system is also widespread in some areas where is no problem with availability of financial institutions. This informal Microfinance Institutions work on system of rotation of lending money among the local people often with minimal or no interest. The basic capital is mostly provided by donors such as Ministry of Planning, NGO or foreign donors.

One of the areas where rotational system is widespread is Ghorsafi – area on the coast of Dead Sea. In this difficult conditions living people are using many kind of this system. There is also rotational system specially for women providing by Women Association. Ministry of Planning grants this Association by 20 000 JD. Than this money rotate among the local people. Beneficiaries are supposed to service the payment monthly with the small interest. Term of expiration is one year than this money are lend to somebody else.

Another rotational system – providing by The Jordanian Hashemite Fund for Human Development – designed for manufacturing. Size of loan is 500-5000 JD and term of expiration is 30 and 12 months. This rotational system is used by 500 families. The payment is serviced monthly with 0-1% interest (until year 2006) and 9% payable within 5 years (since 2006).

Ghorsafi Association for Social Development is providing more programs. Manunight is rotational system for manufacturing projects.

Habitat is program for housing. Size of loan is 300-4000 JD with term of expiration 1-7 years. Interest is less than 1%. But there is one necessitous requirement for taking a loan. The beneficiar is supposed to take a part in building. It is not possible to pay a construction company with this money. The loan can be used just for material or skilled labour. The local people that are using or are about to use this program are helping with building gratis. After finishing of building the

beneficiary is supposed to help by building a house for another beneficiary. There have been built up 45 houses through this system in Ghorsafi until summer 2006.

National Agricultural Union is providing another rotational system for small farmers. 4000 JD is divided among 10 farmers. They pay back monthly with 0% interest and with discount 25%. That means that National Agricultural Union receive back just 75% of loaned money. This amount of money is then again divided among the farmers. The money rotate until the amount of them will reach 0.

For the poorest families is designed a program ISRAA. Each family receives 3 sheeps. They supposed to give first lamb from this sheeps to another family. For all the time the family has to save the number of 3 sheeps. After years it is possible to sell the redundant sheeps. Presently this system is found in second level in Ghorsafi.

CONCLUSION

The effectiveness of microfinance programs as tools for poverty reduction depends, among other things, on whether and how successfully they address the real constraints faced by the poor. The main contribution of microfinance - savings, credit and insurance - is to help people to overcome financial constraints. The main assistance of microfinancing may be gathered as follows

- promote investment in assets
- facilitate activities to earn a livelihood
- protect against income shocks

Support of local private sector by microfinancing helps

to develop small and medium enterprises, and thereby to economic and social growth in local area which approve globally in national economic growth in last consequence.

The microfinancial sector is still developing and extending. The conditions suited on the poor help those people to get better access to financial services. In those areas where is worse access to financial services are often used various informal MFIs such different kind of rotational systems.

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Tab. 1. :

Credit Scoring System

Criteria	Details	Ans	Point
First Criterion Individual Characteristic of Applicants(5 point each)			
1-1	Age		
1-2	Marital status		
1-3	Occupational status		
1-4	Educational level		
1-5	Credit History with(DEF)		
1-6	Job experience		
Second Criterion Project Characteristic(feasibility study)(5point each)			
2-1	Project Sector		
2-2	Location		
2-3	Beneficiary contribution		
2-4	IRR		
2-5	Bay Back period		
2-6	Jobs opportunities to by		
Third Criterion Collateral (40 points for 3.1or3.2)			
3-1	Salary		
3-2	Mortgage		
Fourth Criterion weighted criterion (5point each)			
4-1	Project share (local market)		
4-2	No of similar projects (same		
4-3	Dependents		
4-4	Residence owner ship		
Total (100 points)			

Source: presentation of DEF,2006

