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Exploring the Role of Microfinance in Entrepreneurship and Socio-Economic Development

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ABSTRACT

The aim of the paper has been to investigate the linkage between the micro-finance and entrepreneurship development in developing and emerging economies viz. India. Despite, the tremendous strides in terms of growth of banking sector in India, a large sector of the Indian population still remains unbanked and under developed. Thus, the paper tried to explore the role of micro-finance in entrepreneurship development which leads to socio-economic development and sustainable economic growth in countries like India. Micro-finance is a credit methodology which involves provision of financial services through institutions (micro-finance institutions) to low income people or micro-entrepreneurs that have least access to financial services or where the financial institutions fail to provide services. Without availing credit to such a large chunk of population one cannot think of inclusive economic growth. This paper endeavours to focus on the importance of micro-credit for rural micro-entrepreneur and the overall social upliftment and economic development.

Key Words: Micro-finance, Entrepreneurship development
JEL Classification: G0, G21

INTRODUCTION

More than 500 million of the world population live below poverty line. These people are deprived of the basic necessities of life like food, water, shelter and primary health care. But they earn their livelihood by self-employing themselves as micro entrepreneurs or working in some small and microenterprises which employ up to 5 people. These households lack the access to seed financial capital to run their micro businesses and miss the opportunity for growth (Egwuatu, 2008; and Akingunola *et al.*, 2013). In developing countries, more than 90 per cent of the people lack access to the financial institutions which restricts the ability of entrepreneurs to start up new business ventures, inhibiting socio-economic development and their overall sustainability. This deprivation of finance and credit has further accelerated the vicious cycle of poverty in low developed countries by restricting productivity, inhibiting incomes and domestic savings.

Micro entrepreneurs need small seed capital/start-up capital for establishing microenterprises but it is difficult for poor people to manage such a small capital, which resultantly hinders the growth of micro-enterprises (Robinson, 2002). These small and micro enterprises play an important role

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in the social and economic development of any nation. They constitute 99.7 per cent of all the German enterprises, generate 39.1 per cent of overall turnover and contribute 46.7 per cent of total gross value added in Germany (IFM, 2007 and Hammann *et al.*, 2009). Micro and small enterprises often live under tight liquidity constraints and are a serious matter of concern (Da Silva *et al.*, 2007). Therefore, in most developed and developing countries, there has been an increased attempt to introduce credit programmes for the development of these small and medium scale enterprises (SMEs). The SMEs help in creating employment opportunities, income generation and provide a source of livelihood for the majority of the poor (Obamuyi, 2009). Though the promotion and development of SME has been the main objective of successive governments since 1947, in India, still this macro policy regime has continuously remained biased in many ways (Chowdhury, 2007). Furthermore, trade and taxation policies, allocation of public sector investment in particular have been anti-SME development (ADB, 2002). In developing countries like India the concept of microfinance is differently understood. For instance if any SHG (self-help group) gives loan for any developmental activity it is perceived as microfinance but if any commercial bank gives similar loan it is most unlikely treated as microfinance. The reason behind this myth is that micro-finance is bound by some value attributes which are:

i) Microfinance is and activity undertaken by different sectors like, NGO's and SHG's ii) Microfinance is something done for poverty eradication and iii) Microfinance institutions grow out of commercial developmental context and are termed as alternate commercial sector (Agarwal and Vohra, 2012).

Thus microfinance helps in alleviation of poverty and supports the socio-economic development process. However, certain obstacles hamper the role of microfinance in entrepreneurship and socio-economic development and sustainability in reducing poverty in developing countries around the world. An entrepreneur is a person with knowledge, skill, initiative, ideas and spirit of innovation who puts them into effect in fostering economic growth and development. He identifies opportunities and exploits them for economic growth. Entrepreneur has an important role in the development of agricultural, industrial and service sector of a country. For the agricultural and industrial activities, entrepreneurs need funds to bring together the factors of production i.e., land, labour and capital. Therefore, to carry out these business activities, the microfinance institutions have designed special assistance programs in the form of finance, extension and advisory services, training and provision of basic infrastructure to promote entrepreneurship (Dar and Mir, 2013).

Microfinance essentially is a form of financial inclusion consisting of different financial products (micro-credit, micro-leasing, micro-insurance, micro-savings and money transfers) which are primarily focussed on eradicating poverty. People, who are in a financially weak position, receive these financial services but economically active because they have limited access to standard financial institutions and professional banks, which do not generally invest in initiatives of micro-entrepreneurs, microenterprises and low-income individuals. For such a realization, microfinance assists the extreme poor or the bottom-of-the-pyramid so they can be transformed from mere dependants to active vendor of development through engaging in active economic activities (Shultz and Pecotich, 1997 and Nkamnebe, 2005). Plethora of literature has accumulated over the years to explain the role of micro financing in appeasing entrepreneurship and socio-economic development in the developing economies.

Statement of Problem

Finance is considered as one of the most risky venture capital especially in the early stage of business. It has been a strategic resource for the development of micro and small entrepreneurs to market their ideas into products and services. Shortage or deficiency of finance has been a limiting factor for their growth and also responsible for their sickness. This has resulted in low economic in developing countries, which leads to more poverty, unemployment and poor standard of living. It has prompted developing countries to establish microfinance banks, which provide small loans in the form of micro-credit to such micro-entrepreneurs. These micro-entrepreneurs do not have an access to the formal finance from commercial banks as they do not fall under their vicious criteria of financing. Thus, microfinance is often considered as an instrument for poverty reduction as it address the livelihood patterns of poor people in both developing and under-developed economies. Therefore, to achieve the goals of inclusive development i.e. development of all the classes of society, it has become imperative to examine the role of microfinance on entrepreneurship development and socio-economic development.

OBJECTIVES

The aim objective of the study was to understand the relationship between microfinance, entrepreneurship and socio-economic development.

METHODOLOGY

The review methodology has been employed for collecting the secondary data as the study was based of secondary data. Review of the papers related to microfinance, entrepreneurship and socio-economic development was done and the insights were drawn which linked microfinance, entrepreneurship and socio-economic development. The papers were accessed from the e-resources databases like Emerald Insights, Taylor and Francis, Sciencedirect- Elsevier, Springer Link etc. The study first reviewed theories explaining the effect of finance on entrepreneurship, then, it examined the effects of microfinance on socio-economic development.

RESULTS AND DISCUSSION

Microfinance was considered as an important tool of poverty reduction (Mosley, 2001; Armendariz and Morduch, 2005; Khandker, 2005; Banerjee *et al.*, 2009). Robinson (2001) emphasized that microfinance was a small scale financial services to the poor that involved mainly saving and credit services. Ogunleye (2009) opined that microfinance was about providing financial services to the poor, who were not being served by the conventional financial institutions. Ojo (2009) studied that there was a significant effect of microfinance institutions activities in predicting entrepreneurial productivity. Todaro and Smith (2006), defined microfinance as 'the supply of credit, saving vehicles and other basic financial services made available to the poor and vulnerable people who might otherwise have no access to them or could borrow only on highly unfavourable terms'. This perspective projected microfinance, not only as a scheme for very poor but also as a tool for fund mobilization and allocation among active economic players. Therefore, entrepreneur was the major and indispensable factor in the socio-economic development and was considered key for the economic growth of any nation (Samson *et al.*, 2013). Microfinance can rightly be said as 'instrument of development' (Koveos and Randhawa, 2004).

Impact of Microfinance on Entrepreneurship Development

The major contribution of microfinance to the developing countries like India has been towards the promotion of entrepreneurship development (Osunde and Mayowa, 2012). Lawal *et al.* (2000) considered entrepreneurship as the process of identifying business opportunities and organizing the resources in a way to initiate a successful business activity. The various functions performed by entrepreneurs include: searching for new information/ opportunity; converting opportunity into new markets, services and goods; allocating economic gains; mobilizing the financial resources required for the enterprise; taking the managerial responsibility; and potential to bear the business risk. Lehimer *et al.* (2013) had classified entrepreneurs as necessity-driven and opportunity-driven depending upon the developmental stage of the country. Necessity entrepreneurship was driven by survival, subsistence production and self-employment whereas, opportunistic entrepreneurship was driven by profitability and was likely to be sustainable. It was a kind of investment through the identification of market needed and in particular the market gaps (Acs, 2006).

According to Kiiru (2007), microfinance played an important role in reduction of poverty through entrepreneurship under three conditions. Firstly, the poor should had a minimum basic level of entrepreneurial ability and skills. Secondly, micro-entrepreneurs should be able to identify market opportunities. Thirdly, the poor/micro-entrepreneurs should be able to repay at existing market interest rates since they were improving their financial status. This condition guaranteed the sustainability of microfinance institutions. These three conditions were valid only in opportunity-driven entrepreneurship. Elle (2012) found that microfinance institutions boost entrepreneurship through financial expansion and preferred to supply lending, money-transfer, savings, micro-insurance and training services to micro-entrepreneurs. It had been studied that microfinance institution credit schemes had positive and significant relationship with the performance of micro-entrepreneurs/small scale enterprises and extension of GDP in the economy (Popoola, 2014).

Copestake *et al.* (2001) analyzed the impact of microfinance on firm's individual well-being and business performance. Microfinance had an important role in the development of the micro-entrepreneurs and small enterprises. Micro enterprises not only needed credit but also needed variety of other services like savings, insurance and money transfer in promoting sustainable micro entrepreneurship (Bharti *et al.*, 2006). The results of various studies showed that the microfinance and various activities performed by microfinance institutions helped in determining the pattern of micro enterprise development. The generic model of regression for microfinance and entrepreneurship was:

$$\text{Entrepreneurship} = \alpha + \beta\,(\text{Microfinance}) + \varepsilon$$

where,

α was the intercept,
ε was the error term and
β was the slope coefficient on the key microfinance explanatory variable.

Impact of Microfinance on Socio-Economic Development

Microfinance an empowering and bottoms-up tool to counteract poverty and has been providing considerable economic and non-economic externalities to low-income households in developing countries (Singh and Yadav, 2012). Robinson (2002) opined that financing the poor was both economically and socially profitable. Economies can achieve better economic growth only when the marginalised section of society was financially sound.

Niekerk (2008) believed that microfinance was an important determinant in the healthy economic growth achieved through well-structured framework of microfinance at grassroots level. He emphasized that micro credit and micro insurance was an important drive for energizing an economy and should be extended to the active sector of economy other than poor.

Microfinance also affects the individual well-being of the firm. Copestake *et al.* (2001) established a link between availability of microfinance and overall well-being of the poor. Gobbi (2005) opined that microfinance was an important tool of social change and strived towards the improvement of social and economic status of women.

Iweala (2005) asserted that the entrepreneurial capability can be significantly enhanced through the provision of micro financial services to entrepreneurs by engaging them in more economic activities which was to more self-reliant, increases employment opportunities, enhances household income and creates wealth for the poor. Microfinance facilitated in the creation of new job opportunities and also had new orientation to start their own business. It helped in generation of wealth and assisted in raising the standard of living for them, their families and the nation. The above literature depicted that microfinance had significantly positive impact in the socio-economic development of the nation. The regression model for microfinance and socio-economic development is:

Socio-economic Development =

$\alpha + \beta$ (Microfinance) $+ \varepsilon$

where,
α was the intercept,
ε was the error term and
β was the slope coefficient on the key microfinance explanatory variable.

CONCLUSION

Microfinance has been considered as an important agent for the overall development of the economy. It has positive impact on the entrepreneurship development and social and economic health of the nation. Microfinance was assumed as the best remedy for poverty reduction and helped in raising the living standard and welfare of the marginalised people, who had no access to the formal banking system. Microfinance not only constituted the micro-credit but also involved insurance, savings and other services. It mostly addresses the rural unemployment problem by generating employment opportunities through the development of small scale enterprises. Microfinance institutions had a large role to play when it came to reducing income distribution disparity between the poor and the rich. Thus, microfinance strengthened the National Mission on Financial Inclusion (NMFI) and schemes like Pradhan Mantri Jan Dhan Yojana (PMJDY) was launched by Government of India. Such schemes aimed at bringing all households in India under the ambit of banking facilities and foster economic growth and prosperity. Further, the development of entrepreneurship depended on the entrepreneurial ability and willingness and type of entrepreneur i.e. necessity motive or opportunity motive. Future research studies should focus on other determinants of entrepreneurship and socio-economic development and incorporate them in the overall development models. This will assist the strategists and policy-makers to formulate better strategies for innovative entrepreneurship.

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