The role of Microfinance in economic development

By Prof. Vince Sinining, PhD

On November 21-22, 2019 financial service providers, networks, regulators, partners and investors convened at Nobleza hotel in Kigali, Rwanda for the East Africa Microfinance Summit hosted by the Association of Microfinance institutions in Rwanda (AMIR) in partnership with the East African Microfinance Summit (EAMFINIT) under the theme: *Accelerating Women and Youth Economic Empowerment through Financial Inclusion Agenda.*

As explained by John Peter Rwema, the executive director of AMIR, the summit was an opportunity for stakeholders and experts to engage and share experience so as to devise better mechanisms on how to further enhance local and Africa's microfinance industry.

Vumi Kacheche, the Head of Programme - Vocational and Commercial education, Maria Knappstein SBFIC Country Director Rwanda (2nd Left), Jules Ndahayo, Chairman of AMIR and Monique Nsanzabaganwa Vice Governor BNR (Centre), Joel Mwakitalu Coordinator at EAMFINET and Aimable Nkuranga, Executive Director AMIR and delegates at East Africa Microfinance Summit2019 in Kigali (PHOTO/George Kalisa)

Financial experts are unanimous in their belief that microfinance plays an important role in economic development.

First, let us understand what the microfinance institutions (MFIs) are. They are bankers and lenders who provide microfinance services, such as deposits, loans, payment services, money transfers, and insurance. These institutions provide the much-needed financial services to poor and low-income households, entrepreneurs, who would otherwise not have access to such financial services.

Second, let us know what microfinancing means. Originally, it started as a means to grant small loans, savings accounts and insurance to persons to help them launch small businesses or engage in other economic activities in order to overcome poverty. Its main purpose is to finance small businesses operated by the poor and to provide individuals, families and communities with financial assistance to become self-sufficient.

Undeniably, microfinance is considered globally as one of the most effective tools in reducing poverty. Traditionally, microfinance institutions were generally nonprofit or governmental institutions that sought to help the poor.

According to MicrofinanceInfo.com, a website that provides information and resources related to microfinance, the goals for microfinance institutions, and hence the function of microfinance is to:

- Be a viable financial institution developing sustainable communities.
- Mobilize resources to provide financial and support services to the poor, particularly women, for viable productive income generation enterprises enabling them to reduce their poverty.
- Learn and evaluate what helps people to move out of poverty faster.

- Create opportunities for self-employment for the underprivileged.
- Train rural poor in simple skills and enable them to utilize the available resources and contribute to employment and income generation in rural areas.

If microfinancing is meant to help the poor and reduce poverty, there is no question then of its significant role in economic development. Giving our youth, women and low income families the small loans to help them break the cycle of poverty will eventually lead to long-term financial stability thereby improving their livelihoods.

Indeed, in countries like Rwanda, microfinance plays a central role in the country's economy. Many countries, including Rwanda still rely on international financial aid or microfinance activities to balance annual budgets or fund social programs.

On the difference between microfinance and microcredit, microfinance is a financial practice that helps improve living conditions for the poor and unemployed in the short term and long term. Microcredit or small loan is the lending of small amounts of money at low interest to low-income individuals who are interested in setting up a small business with no credit reference or asset to provide as collateral. Collateral is something pledged as security for repayment of a loan, to be forfeited in the event of a default. A young entrepreneur seeking funding for a startup business may apply for a microcredit with a local microfinance bank.

Rwanda's experience on Microfinancing

The growth of microfinance sector in Rwanda began in the mid-70s. The large inflow of donor funds directed towards relief oriented microfinance initiatives following the genocide in 1994, has contributed largely on the growth from the late 1990s. The Government of Rwanda has also provided credit lines and grants to the microfinance sector to fast-track reconstruction. In 1995, the

Government launched a financial sector reform programme. In 1996, the limited success of these reforms was made apparent by the collapse of nine (9) microfinance institutions (MFIs) that lead to 195,000 depositors losing their savings. In 2006, a formal National Microfinance Policy, accompanied by an implementation strategy, was introduced. During this year, the microfinance sector in Rwanda had become a haven for the thieving financial players which prompted government's intervention by bringing into force the law on regulation that had been passed the previous year.

In August of 2008, the Rwandan parliament adopted a specific microfinance law (Law No. 40/2008) to strengthen the microfinance sector and better protect public deposits. It was followed by the publication of a new National Bank of Rwanda (BNR) Instruction for MFIs (No. 02/2009), defining the BNR as the main regulatory body overseeing the microfinance sector.

The 2008 FinScope report revealed that only 48% of Rwandan adults had access to financial services and products – both formal and informal. Given the relationship between access to financial services and economic development, the Government of Rwanda and DFID established AFR in 2010, with a core mandate of promoting financial inclusion. DFID, the World Bank, and KfW were the initial funders of AFR.

Access to Finance Rwanda (AFR) is a Rwandan not for profit company established in 2010 by the UK's Department for International Development (DFID) and the World Bank in partnership with the Government of Rwanda and the German Development Bank, KfW later joining in as a donor. Access to Finance Rwanda is part of the broader Financial Sector Deepening (FSD) Network of programs in Africa that seek to create a transformative impact on the reduction of poverty by supporting efforts to improve financial inclusion and by helping financial institutions and markets drive economic growth.

KfW Development Bank has been helping the German Federal Government to achieve its goals in development policy and international development cooperation for more than 50 years. KfW’s goal is to help its partner countries fight poverty, maintain peace, and protect both the environment and the climate and shape globalization in an appropriate way.

As per the data released by AMIR in June 2016, microfinance sector in Rwanda was comprised of 13 limited companies; 64 non-Umurenge SACCO and 416 Umurenge SACCO. For the last couple of years the sector’s asset grew by 28.8% from Rwf 128.7 billion to Rwf 159.3 billion which was largely driven by loans that rose by 22.4%. On the liability side, deposits increased by 23.9% from Rwf 69.5 billion in 2013.

Rwanda Microfinance Sector registered total assets of Rwf 208.9 billion, total deposits Rwf117.28 billion, and a loan portfolio of Rwf 111.37 billion. The Non-Performing Loans were at 7.9% and accounts opened were at 40% by the end of February 2016.

Access to Finance Rwanda (AFR) reported that the share of loans over total assets of the microfinance sector increased from 53% in December 2015 to 57% in December 2016. The reduced pace of lending from MFIs is due to an increased vigilance surrounding prudential lending caused by credit risk concerns arising from poor agricultural performance in 2016. The report indicated that agriculture remains a key lending sector for MFIs and accounts for 30% of Umurenge Savings and Credit Co-Operative (SACCO) loans and 15% of total MFI loans.

The importance of microfinance, and thereby of microfinance institutions, is arguably one of the most effective tools for reducing poverty. Microcredit loans made available to villagers, impoverished women and poor families have a greater purpose of serving economically-marginalized populations.

During the microfinance summit held in Kigali, it was noted that the Rwandan government has recognized the contribution of the microfinance sector in the improvement of the livelihoods of Rwandans, especially smallholder farmers through the development of agriculture which claimed the largest share of loans offered by MFIs and SACCOs. It was reported that MFIs and SACCOs mostly served smallholders farmers and agri-lending comprised 40% of these institutions' portfolios. In Rwanda, the microfinance institutions have contributed in the development of the agriculture sector, from the inputs and production to value chain.

Currently, 3.7 million Rwandans are served by the microfinance sector. It is projected that in ten years, most Rwandans, if not all, will be financially included besides the diversified products being offered that match the needs and preferences of different segments of the population following the digitalization of the microfinance sector.

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