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The Role of Access to Finances and Poverty Reduction in Developing Countries. A Critical Literature Review

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Abstract

Purpose: Financial institutions improves the well-being of participants through job creation, increasing income and building assets (wealth). It makes poor people to be homeowners through schemes such as housing microfinance. The overall objective of this study was to examine influence of access to finances and poverty reduction in developing countries. A critical literature review

Methodology: The paper used a desk study review methodology where relevant empirical literature was reviewed to identify main themes and to extract knowledge gaps.

Findings: This study concluded that access to home improvement finances led to improvement in living conditions from living in shanties to permanent dwellings hence better living conditions and reduction in poverty. Access to school fees loans led to higher enrolment rates in schools improving literacy levels in developing countries and hence reducing poverty. Lower interest rates led to more access to microfinance loans and in the long run a reduction in poverty, availability of collaterals meant ability to pay and credit worthiness of respondent's hence easier access to microfinance loans which leads to poverty reduction in the long run. Favourable credit policy led to increased access to microfinance loans and vice versa.

Unique Contribution to Theory, Policy and Practice: This study recommended that financial institutions that are able to give out loans to help serve the poor, should arrange mechanisms to improve technical and business skills of the poorest through training and loan utilization. This will enhance their business skills to use credit and establish market channels for their products.

Keywords: *Influence, Access, Finances, Poverty Reduction, Developing Countries*.

INTRODUCTION

Improved access and efficient provision of savings, credit, and insurance facilities enable the poor to smoothen their consumption, manage their risks better, and build their assets. Thus, microfinance is not just financial intermediation banking, but also social intermediation as a development tool (Smollen, 2021). On the other hand, microfinance clients are, in most cases, self-employed, low-income entrepreneurs in both urban areas artisans, kiosk owners, small scale traders, mobile street vendors or hairdressers and rural areas blacksmiths, pottery artisans or small scale farmers in the formal and informal sectors. Microfinance, by providing small loans and savings facilities to those who are excluded from commercial financial services has been developed as a key strategy for reducing poverty throughout the world. Microfinance scheme allow poor people to protect, diversify and increase their sources of income, the essential path out of poverty and hunger (Who, 2021).

As a developmental and economic tool it had caught the imagination of banks, financial institutions and Non-Governmental Organizations (NGOs) in Kenya. In the global arena there is already the impression that microfinance is successful in reducing poverty. Many policy makers are therefore engaged on how to make microfinance sustainable and available to many poor households in the future. Many stake holders in the microfinance industry especially donors and investors argue that Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor households (Consultative Group to Assist the Poorest (CGAP, 2018).

The overall message in this argument is that unless microfinance providers charge enough to cover their costs, they will always be limited by the scarce and uncertain supply of subsidies from governments and donors. The main underlying assumption in this argument is that microfinance is already good for the clients, and therefore what is really urgent is to make the financial service available to as many poor people as possible. Batista (2020) correctly points out that this kind of enthusiasm for 16 microfinance rests on an enticing win-win proposition for Microfinance institutions that follow the principles of good banking will also be the ones that alleviate the most poverty. The assumption being that with good banking practices it is possible to cover costs and operate in a sustainable manner to continue serving clients and alleviating poverty (Batista 2020).

Developing countries, has been struggling to reduce poverty. One of the interventions has been the introduction and implementation of social and economic policies which address the issue of poverty both at national and individual levels. This involved State intervention in education and other social services, and the creation of an enabling environment for private sector investment in productive sectors (Shimaless,2016). During the World Social Summit held in Copenhagen in 1995, Kenya joined other nations in their Commitment to eradicate poverty, Following this commitment, Kenya has developed plans for poverty reduction which are outlined in the Kenya Vision: 2030, the National Poverty Eradication Strategy, Poverty Reduction Strategy Paper (2020) and the National Strategy for Growth and Reduction of Poverty (2005).

All these stress the importance of equitable, sustainable economic growth and improvement of people's welfare. Defining poverty involves the question of whether it is mainly about material needs involving measuring consumption by using income as the main determinant factor, or a much broader set of needs that includes factors of wellbeing. (World Bank,2016) We use the term 'poorest of very poor' to refer to people living on less than $1 per day. We also use the term 'poor' to mean those living in poverty above $1 per day or in the upper half of those living below their nation's poverty line. The 1st Millennium Development Goal (MDG) is to eradicate extreme poverty and hunger (Jamison,2018). This has become an issue of concern both on the local and international levels since the MDG's was established. The World Bank defined poverty as the state of living on less than $2 a day and this poverty continues to remain elusive to eradicate even for the billion in question (World Bank 2018). They also have yet another definition as having a multi-dimensional nature consisting of vulnerability, powerlessness and social exclusion in addition to material deprivation. Poverty in many developing countries is largely a matter of not having enough on their tables to eat. Providing the poor with financial services is one way to increase their income and productivity, e.g. through self-employment and thus escape poverty (Reynolds, 2019). Poverty is explained by individual circumstances and characterized of poor people, such as amount of education, skills, experience, intelligence, health, handicaps age, sex etc.

Poverty can be defined as the state of being without, often associated with need, hardship and lack of resources across a wide range of circumstances. Poverty is further classified into three variables, Income poverty, Vulnerability and Empowerment. Income poverty stands for lack of income to afford minimum basic necessities of life. Vulnerability involves the probability of risk today of being in poverty or to fall into deeper poverty in the future. Regarding Empowerment, the focus of this study is on women. In addition, most MFIs are working towards women empowerment as a primary objective (Dauglay, 2019).

Statement of the Problem

Finances as a tool for poverty alleviation has insufficiently penetrated the poorer strata of society. The International Poverty Centre reported that even in relatively successful countries such as Ghana and Tanzania, only about six percent of the population had access to microfinance services (Hailu, 2018) Access assessment can be used to improve services, increasing impact on poverty and microfinance institution efficiency, to promote good client service and accountability and to provide accountability to donors and other external stakeholders (SEEP, 2021). If the intervention is intended to reduce poverty, it is important to know the degree to which poor people used the existing services, what terms they used and then an intervening organization makes an informed decision on whether their work is likely to augment or displace existing poor financial services (Johnson and Rogaly, 2017). The results of few case studies indicate that access to microfinance could reduce poverty. However, comprehensive assessment research has not yet been conducted to prove it. Very limited researches towards improving the financial sector have been observed

(Wolday, 2013). This study will therefore examine the role of access to finances and poverty reduction in developing countries. A critical literature review

Objective of the Study

The overall objective of this study was to examine influence of access to finances and poverty reduction in developing countries. A critical literature review.

Significance of the Study

The research was carried out to be of benefit to individuals, society, institutions and the nation at large. It provides the public with information and knowledge regarding accessibility of financial services in reference to poverty reduction in developing countries. The project work is beneficial to subsequent researcher who will undertake research in similar or related field of study, as it provide literature regarding micro finance institutions. The research work was undertaken to broaden the knowledge of the researcher and the target population on how effective and efficient access of financial services to the vast majority population of the poor, results in poverty reduction in the region. Moreover the project highlights the benefits which the micro finance institution and the society stand to gain if the constraints on the effect of access to micro finance are minimized.

THEORETICAL REVIEW

This section discusses reaching scale theory and Raiffeisen model theory that support the access of finances and its influence on poverty reduction.

Reaching Scale Theory

The 1990s "saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale" (Robinson, 2001). Dichter (1999) refers to the 1990s as "the microfinance decade". Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these other services (MIX, 2005). The importance of microfinance in the field of development was reinforced with the launch of the Microcredit Summit in 1997. The Summit aims to reach 175 million of the world's poorest families, especially the women of those families, with credit for the self-employed and other financial and business services (Microcredit Summit, 2005). More recently, the UN, as previously stated, declared 2005 as the International Year of Microcredit.

Raiffeisen Model Theory

Originally governments and donor agencies in developing countries set up credit cooperative unions styled on the Raiffeisen model, which was developed in Germany in 1850s to provide agricultural credit to poor farmers. The focus of these credit cooperative unions was to mobilize savings in rural areas in an attempt to "teach poor farmers how to save" (Ledgerwood, 1999).

Although well-intentioned, and designed for economic development, many of these credit cooperatives were perceived either as social welfare programs or political party programs designed to advanced political agendas of political leaders. Modern micro finance emerged in late 1970s with a strong orientation towards private sector solutions. This resulted from evidence that state owned agricultural development banks in developing countries had been a monumental failure, actually undermining the development goals they were intended to serve (Adams et al., 1984). It is the dismal performance of government sponsored credit programs that led to the emergence of microfinance as a market-based approach to address the problem of financial intermediation to serve the poor.

Empirical Review

Abdo (2018), conducted a study to evaluate the effect of investment financing on performance of Islamic commercial banks in Kenya. The study population was the two fully fledged Islamic commercial banks which are First Community Bank Limited and Gulf African bank and five conventional banks that offer partial Islamic commercial banking (Barclays banks of Kenya, National Bank of Kenya, Diamond Trust Bank of Kenya, Kenya Commercial Bank and Standard Chartered Bank of Kenya). The study used stratified random sampling to select the sample. This method is appropriate because the sample represents the target population and eliminates sampling bias. The study used primary data. The study used mean and percentages in this study. The study used Statistical Package for Social Sciences (SPSS) to generate the descriptive statistics and also to generate inferential results. Inferential included both correlations and regression. The study found that mortgage financing, equity financing and trade financing have a positive and significant relationship with performance of Islamic commercial banks. The study concluded that affordable interest rates for mortgages help to improve the performance of the bank. The study was done in Islamic banks presenting a contextual gap.

Ndemi (2018), conducted a study that evaluated the effect of financing options on the financial performance of SMEs in Nanyuki Town, Kenya. Specifically, the study assessed the effect of formal financing, personal financing, informal financing and government funds on financial performance of SMEs. Financial performance of SMEs was evaluated from a liquidity and profitability point of view for more objectivity. The study was conducted in Nanyuki town which has a fine mix of thriving SMEs that are the drivers of economic life in the town. The target population was made up of the SMEs and their owners in the town. The study targeted 765 SMEs in Nanyuki town. The sample was picked using stratified sampling technique. Correlation analysis as well as ordinary least squares regression were employed to determine effectively the effect and nature of associations between the variables. The study found poor liquidity condition for the SMEs with both the current ratio and quick ratios standing 1.47:1 and 0.55: 1 respectively which are below the globally accepted standards. The study presented a conceptual gap as it focused on evaluating the effect of financing options on the financial performance of SMEs in Nanyuki Town, Kenya while our study will focus on examining influence of access to finances and poverty reduction in developing countries.

Gitihu (2016), conducted a study on how gender concerns have been incorporated and addressed in five anti-poverty projects in Majengo slum in Nyeri County. The study design used was descriptive with both qualitative and quantitative techniques. The findings showed that the gender of an individual influences their poverty levels and that women more than men, seeking economic empowerment to meet their financial demands, tend to join project groups which have a positive impact on their social and economic wellbeing which is an important indicator in poverty reduction. The study presented a methodological gap as it utilized descriptive research design while our study will utilize a desktop review approach.

Muturi (2012), conducted a study that the examined the performance of selected Micro finance Institutions in Nairobi especially as relates to their provision of credit to SMEs. The study realized that MFIs have a huge role to play towards poverty alleviation through credit accessibility to SMEs. Their performance was, however, affected by factors such as limited financial resources, delinquent loans, and loans lack of a management information system, wide geographical coverage, poor research and development department, among other factors. Sustainability was also found to be a thorny issue. Achievement of sustainability was found to be constrained by factors such as inadequate savings by clients, huge operating costs, and provision of non-financial services, legal constraints, and subsidized interest rates, among others. The study found out that the regression results were not significant at 5percent level of significance. However, there was positive correlation between the dependent variable (performance) and loan amounts, repayment rate and sustainability. Cost per unit of currency lent was negatively correlated to performance. The study however presented a geographical gap as it focused on Nairobi in Kenya while our study will focus on developing countries.

METHODOLOGY

The study adopted a desktop literature review method (desk study). This involved an in-depth review of studies related to influence of access to finances and poverty reduction in developing countries. Three sorting stages were implemented on the subject under study in order to determine the viability of the subject for research. This is the first stage that comprised the initial identification of all articles that were based on influence of access to finances and poverty reduction in developing countries. The search was done generally by searching the articles in the article title, abstract, keywords. A second search involved fully available publications on the subject on influence of access to finances and poverty reduction in developing countries. The third step involved the selection of fully accessible publications. Reduction of the literature to only fully accessible publications yielded specificity and allowed the researcher to focus on the articles that related to influence of access to finances and poverty reduction in developing countries which was split into top key words. After an in- depth search into the top key words (influence, access, finances, poverty reduction, developing countries), the researcher arrived at 4 articles that were suitable for analysis. This were findings from:

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SUMMARY, CONCLUSION AND RECOMMENDATIONS

Conclusion

This study concluded that access to home improvement finances led to improvement in living conditions from living in shanties to permanent dwellings hence better living conditions and reduction in poverty. Access to school fees loans led to higher enrolment rates in schools improving literacy levels in developing countries and hence reducing poverty. Lower interest rates led to more access to microfinance loans and in the long run a reduction in poverty, availability of collaterals meant ability to pay and credit worthiness of respondent's hence easier access to microfinance loans which leads to poverty reduction in the long run. Favourable credit policy led to increased access to microfinance loans and vice versa.

Recommendations

This study recommended that financial institutions that are able to give out loans to help serve the poor, should arrange mechanisms to improve technical and business skills of the poorest through training and loan utilization. This will enhance their business skills to use credit and establish market channels for their products. Lastly, financial donors need to put a lot of care to ensure that income-generating activities of their loan recipients are profitable and loan products appropriate. Otherwise, loan recipients may need to convert what they have saved as goods into cash to repay their loans, thus depriving themselves further.

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