

## **The Challenges Facing Microfinance Institutions in Poverty Eradication: A Case Study in Mogadishu**

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**Abstract:** *The purpose of this paper is to introduce practical evidence about challenges facing microfinance institutions in poverty eradication and to examine what role microfinance institutions can play in eradication of poverty in Mogadishu.*

*A survey research method has been adopted to examine challenges facing microfinance institutions in poverty eradication. The data were collected through questionnaires filled by the respondents equally selected from **Salaam Somali bank** and **Sa'id foundation** in Mogadishu, Somalia. The results of the questionnaire were then analyzed with the aid of SPSS.*

*The results showed that the microfinance institutions have a positive impact on alleviation of poverty among poor people. Misconception about microfinance institutions due to their newly inception, inadequate loans, less mentionable support from government and donor funding hinder the microfinance institutions flourishing and hence this research provides contribution in the field of microfinance in poverty eradication.*

**Keywords:** *Challenges, Microfinance Institutions, Poverty Eradication*

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### **1. INTRODUCTION**

In South Asia, the microfinance has developed out of experiments, but the best known start was in Bangladesh in 1976, when Muhammad Yunus set up the Grameen Bank on the suburbs of Chittagong University campus in the village of Jobra. According to Nanor (2008) in Africa, 1980s it was first time micro-credit movement spread and this program became stronger in 1990s. Sa'id Foundation started its micro-credit program in 1993, Mogadishu, and SA'ID received its first substantial capital injection from Oxfam America in 1996 (SA'ID report, 2005). Salam Somali Bank also launched microfinance program to help the poor people in Mogadishu since 2010 (Salam Somali Bank Website, 2011). According to Otero (1999), Microfinance is the provision of financial services to low income poor and very poor self-employed people, these financial services include savings and credit but can also include other financial services such as insurance, transfer of payment services and remittances. Microfinance involves the provision of financial services such as savings, loans and insurance to poor people living in both urban and rural areas and who were excluded to obtain such services from the formal financial institutions (Ojo, 2009). Microfinance is the provision of financial services such as credit (loans), savings, micro leasing, micro-insurance and payment transfers to economically active poor and low income households to enable them engage in income generating activities or expand/grow their small businesses (Irobi, 2008). According to Robinson (2001), microfinance defined as the provision of loans, savings and other basic financial services to the poor people and low-income groups.

According to Matovu (2006), microfinance can be an effective tool to use poverty reduction and plays an important role in poverty alleviation. Microfinance is referred as provision of savings, credit, and insurance facilities can enable the poor people to smooth their consumption, manage their risk better, gradually build their asset base, develop their micro enterprises, enhance their income earning capacity, and enjoy an improved quality of life (kessy, 2006). Salaam Somali Bank and a few number of non-governmental organizations, such as Sa'id Foundation started microfinance services target the poor people and their coverage has remained minimal and mostly confined to urban areas (Aden, 2011). Therefore, this study investigates the challenges facing microfinance institutions in poverty eradication in Mogadishu. This paper examines the role of

microfinance institutions in poverty eradication and also investigates challenges facing microfinance institutions in poverty eradication.

## **2. LITERATURE REVIEW**

Microfinance (MF) has evolved as an economic development approach intended to benefit the low-income part of a given society (both women and men). According to the World Bank definition, the term refers to 'provision of financial services' (including saving and credit) to 'the poor'. Micro finance banks are institutions that are established to provide financial services to the active poor. Microfinance Institutions, (MFIs) can be non-governmental organizations (NGOs), saving and loan cooperatives, credit unions, government banks, commercial banks, or non-bank financial institutions (Ledgerwood 1999). Microfinance gives access to financial and non-financial services to low-income people, who wish to access money for starting or developing an income generation activity (Ojo, 2009). Microfinance came into being from the appreciation that micro-entrepreneurs and some poorer clients can be 'bankable', that is, they can repay, both the principal and interest, on time and also make savings, provided financial services are tailored to suit their needs( Khan & Rahaman 2007).

Irobi (2008) investigated microfinance and poverty alleviation Nigeria, this study was employed questionnaire. His study found the microfinance intervention has a positive impact on alleviation of poverty among the women of this association. Interestingly, this study found that most women in this association experienced increased income and therefore, improved their economic status, political and social conditions after receiving the loans. While James at ell (2011), they examined impact of microfinance on poverty alleviation in Nigeria: An Empirical Investigation. This paper was employed in chi-square test, F-test and T-test. Their findings revealed that there is a significant difference between those people who used microfinance institutions and those who do not use them. There is a significant effect of microfinance institutions in alleviating poverty by increasing income and changing economic status of those who patronize them. Their study concludes that microfinance institution is indeed a potent strategy of poverty reduction and a viable tool for providing credit to the poor.

In the contrast, according to Provident & Zacharia (2008), investigated critical look at the role of microfinance banks in poverty reduction in Tanzania, the study based on questionnaires, semi structured interviews, observations and documentary reviews. The main findings of their study showed that majority of the poor do not access microfinance services loans because they lack guarantors, assets, businesses, salaried employment, savings account in banks, ability to make pre-loan weekly deposit on Special Savings Account which are required as collaterals.

According to Muhammad (2010), focus on the challenges and opportunities face microfinance sector in Pakistan, his study resulted that numerous challenges are ahead of microfinance sector like improper regulations, increasing competition, innovative and diversified products, profitability, stability, limited management capacity of micro finance institutions (MFIs) etc. On the other hand, the rapid increase in poverty in Pakistan, along with other opportunities, is paving way for the growth of this sector and offering a huge market potential for microfinance. On this basis the sector presents a lot of opportunities such as: stimulating growth of economy, women empowerment, increasing volume, accessibility and outreach, economics of scope.

## **3. METHODOLOGY**

### **3.1. Research Design and Target Population**

This study was employed descriptive study; the purpose of descriptive research is to describe an accurate profile of persons, events or situations. In addition to, this study will be used quantitative approach. Quantitative is any data collection technique (such as a questionnaire) or data analysis procedure (such as graphs or statistics) that generates or uses numerical data (Saunders et al, 2009). The study was conducted in survey research approach. Surveys are information-collecting method use to describe, compare, or explain individual and societal knowledge, feelings, values, preferences, and behavior (Fink, 2009). This study was conducted among microfinance institutions in Mogadishu. The researcher selected a number of organizations such as Salam Somali Bank, and SA'ID Foundation. The researcher selected those institutions because they are the main institutions that provide microfinance programs in Mogadishu. The sample size of this study would be 80 of respondents.

### 3.2. Sample Procedure

The data for this study were collected through questionnaires that were administered to microfinance institutions operating in Mogadishu. Questionnaire was used in view of the reality that the study is concerned with variables that cannot be observing such information is best way of collecting data through questionnaires (Saunders et al, 2009). The questionnaire contained three sections, namely demographic information, i.e. gender, age, level of education and experience, research objective one and research objective two accompanied by a five point Likert scale.

## 4. FINDINGS

### 4.1. Profile of Respondents

The profile of respondents was analyzed and presented the following tables. It contained gender, age, education level and experience.

Gender	Frequency	Percent
Male	51	63.8
Female	29	36.2
Total	80	100.0

Source: Survey Data 2013

The respondents were 63.8% male, and 36.2% female. Therefore, the majority of the respondents were male and they were the employees of Salam Somali Bank and Sa'id foundation in Mogadishu.

Age		
Class	Frequency	Percent
20-30	42	52.5
30-40	25	31.2
40-50	9	11.2
50 above	4	5.0
Total	80	100.0

Source: Primary data, 2013.

83.7 % of the respondents were aged between 20-40 years which indicated that the majority of employees of microfinance institutions in Mogadishu were junior.

### 4.2. Level of Education

Level of Education	Frequency	Valid Percent
Secondary school	10	12.50
Diploma	25	31.25
Bachelor	41	51.25
Master	4	5.00
PhD	0	0.00
Total	80	100.0

Source: Primary data, 2013

The information given above showed that 12.5% is Secondary school, 31.25% Diploma, 51.25% Bachelor, 5% Master. Therefore, more than half of employees are graduates.

### 4.3. Experience of Respondents

No. of Years	Frequency	Percent
One year	31	38.8
Two years	30	37.5
Three years	8	10.0
3 year above	11	13.8
Total	80	100.0

Source: Primary data, 2013

The table above indicated less experienced employees, they were because 76.3% of them had a work experience between one year and two years.

### 5. ROLE OF MICROFINANCE INSTITUTIONS

No	Role of Microfinance	1	2	3	4	5	%	Mean
1	Microfinance is very important in socio-economic environments and play vital role in reducing poverty	2.5	7.5	7.5	48.8	33.8	<b>82.6</b>	3.91
2	Microfinance is the supply of loans, savings and other basic financial services to the poor people.	2.5	11.2	5	51.2	30	<b>81.2</b>	3.95
3	microfinance is provision of micro-loans and saving to low-income groups, small businesses and poor people	3.8	8.8	22.5	20	45	<b>65</b>	3.94
4	Micro finance banks are institutions that are established to provide financial services to the active poor.	3.8	12.5	17.5	35	31.2	<b>66.2</b>	3.78
5	Role of microfinance institutions are to provide diversified, dependable and timely financial services to the economically active poor	3.8	10	26.2	23.8	36.2	<b>60</b>	3.79
6	Role of microfinance institutions is creating employment opportunities.	1.2	8.8	31.2	31.2	27.5	<b>58.7</b>	3.75
7	Role of microfinance institutions is to provide benefits to the poorest people both an economic and socio well-being point-of-view	3.8	8.8	25	38.8	23.8	<b>62.6</b>	3.70
8	Role of microfinance institutions to help existing business grow or diversify their activities	5	10	15	33.8	36.2	<b>70</b>	3.86
9	Role of microfinance institutions to encourage the development of a new business.	13.8	15	20	22.4	28.8	<b>51.2</b>	3.72
10	Role of microfinance institutions to empower women or other disadvantaged population groups	5	5	32.5	18.8	38.8	<b>57.6</b>	3.81

The results (Table above) indicate microfinance plays a greater role because mean scores for overall of the total sample (3.821), for respondents are significantly greater than the mean scale 3.60. Microfinance is very important for poor people as well as businesses and it is the technique of poverty reduction, and provides diversified, dependable and timely financial services to the poor people and existing business, creates employment, encourages a new business development, and empowers women or other disadvantaged population groups.

### 6. CHALLENGES FACED BY MICROFINANCE INSTITUTION

No	Challenges Microfinance	1	2	3	4	5	%	Mean
1	Inadequate donor funding	2.5	7.5	5	22.5	62.5	<b>85</b>	4.35
2	Insufficient support from governments	2.5	2.5	10	55	30	<b>85</b>	3.75
3	Improper regulations	5	12.5	7.5	30	45	<b>75</b>	3.98
4	Limited management capacity of micro finance institutions	2.5	17.5	25	40	15	<b>55</b>	3.48
5	Less attention on financial sustainability of MFIS	2.5	10	15	60	12.5	<b>72.5</b>	3.70
6	Lack of adequate loan or equity capital to increase loan-able funds.	2.5	7.9	4.6	42.5	42.5	<b>85</b>	3.95
7	Lack of standardize reporting and performance monitoring system for microfinance institutions.	2.5	12.5	25	37.5	22.5	<b>60</b>	3.65
8	Lack of understanding of the definition and concept of microfinance by the clients.	5	8	7	52.5	27.5	<b>80</b>	4.02
9	Major challenges of microfinance institutions are communication gaps and inadequate awareness	10	5	12.5	25	47.5	<b>72.5</b>	3.95
10	There is a danger of systemic credit risk in which default borrowers worsen the whole system.	5	2.5	10	20	62.5	<b>82.5</b>	4.35

The results (Table above) point out the major challenges that face microfinance institutions range from default risk inherited from borrowers and lack of understanding the concept of microfinance by the clients to inadequate donor funding where the microfinance institutions do not have enough adequate capital from donor to meet the needs of the microfinance beneficiaries in order to help those who need assistance of the microfinance. On the other hand, the challenges facing microfinance institutions include insufficient support from government.

## **7. DISCUSSION**

The results indicate that micro finance is important for the society but there is some challenges faced by micro finance institutions in Mogadishu the challenges include inadequate donor funding, insufficient support from governments, improper regulations and also the challenges include Lack of standardized reporting and performance monitoring system for microfinance institutions. The results support the findings of Muhammad and, Irobi (2008,2010), According to Muhammad (2010), focus on the challenges and opportunities face microfinance sector in Pakistan, his study resulted that numerous challenges are ahead of microfinance sector like improper regulations, increasing competition, innovative and diversified products, profitability, stability, limited management capacity of micro finance institutions (MFIs) etc. On the other hand, the rapid increase in poverty in Pakistan, along with other opportunities, is paving way for the growth of this sector and offering a huge market potential for microfinance. On the other hand according to Irobi (2008) found in his study that the major challenges of microfinance institutions in Nigeria are communication gaps and Inadequate awareness; insufficient support from governments; inadequate donor funding; less attention on financial sustainability of MFIs; lack of adequate loan or equity capital to increase loan-able funds; high turnover of MFI staff; limited support for human and institutional capacity building; illegal government and NGO operations that spoil the market; and lack of standardize reporting and performance monitoring system for MFIs .

Finally, the study found that possible ways to reduce the challenges of micro financial institutions is effective communication, adequate awareness, to get full support from local governments and international donors to micro financial institutions in Mogadishu.

## **8. CONCLUSION**

The purpose of this paper is to study the role of microfinance institutions in poverty eradication in Mogadishu and to observe the challenges facing microfinance institutions. The data for this study based on questionnaires were administered to two microfinance institutions in Mogadishu. The results revealed substantial evidence of the importance of microfinance in socio-economic environments and plays vital role in reducing poverty, provides diversified, dependable and timely financial services to poor people and it creates employment opportunities. Therefore, the study found that the microfinance institution has a positive impact on alleviation of poverty among poor people.

On the other hand, the study stated the major challenges that face microfinance institutions are default risk inherited from borrowers, inadequate donor funding, and lack of understanding of the definition and concept of microfinance by the clients. Communication gaps and inadequate awareness, improper regulations, lack of adequate loan or equity capital to increase loan-able funds, insufficient support from governments, and limited management capacity of micro finance are additional challenges to microfinance institutions.

## **9. RECOMMENDATIONS**

The study is recommending the government must give consideration to the micro finance, allocate a substantial budget and donate to these microfinance institutions in order to boost the living standard of people and ultimately contribute towards the economic development and prosperity of the country. The government must also encourage other donor organizations to aid these institutions financially, and come up with rules and regulations to prevent default risk. Alternatively, microfinance institutions must enhance their management capacity and bring effort to reach the needy people in order to eradicate poverty and promote the welfare of the society.

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