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Micro-financing Institutions in Less Developed Countries: Conditions When Appropriate Changes from Informal to Formal Institutions

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Abstract

The year 2005 was declared by the UN General Assembly as the international year of micro-credit. This fact emphasises the significance of micro-finance in the collective effort of the world community to reach the Millennium Development Goals accepted by the United Nations. Micro-finance activities constantly help to reduce poverty and increase the income of the population. Micro-finances are one of the important factors influencing the reduction of public debt of Less Developed Countries. The study characterises the evolution of indebtedness from the macroeconomic viewpoint and micro-finance activities. One of the main questions is when and under which conditions it is acceptable to accelerate the transformation of informal micro-financial institutions into formal institutions. In conclusion the fundamental prerequisites and general conditions for this transformation are defined. The moment for the transformation of informal micro-financial institutions into formal institutions comes when institutions meet three requirements, so-called triangles: (1) Maintenance of the environmental stability in which they operate (critical triangle) - sustainable environment - necessity to prevent hunger - need to reduce hunger in region . (2) External sustainable development of financial institutions — external stability of institutions- financial stability, which secures the sustainable development of institutions - must have sufficient size and quality (stand up to the competition, to broaden provided services and improve their quality) - must have an effective impact on increasing economic stability and prosperity of clients . (3) Internal economic sustainable development of financial institutions — internal stability of institutions (international triangle of economic stability) - profitability — management, where returns exceed costs and micro-financial institutions (MFIs) achieve profit - liquidity — an ability to pay clients on request of their deposits (MFIs do not deal with their own financial resources and together generate cashless financial transactions)- solvency — an ability to pay from one's own ordinary income (or by conversion of property) ordinary costs and obligations in case of losses.

Keywords: Hunger reduction, indebtness, less developed countries, micro-financing, micro-financing institutions

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