Determinants and Consequences of Transactions Costs of Microfinance and their Impact on Rural Poor Peoples Income

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Introduction

Many governments and non governmental organizations advocate for microfinance as a poverty reduction tool. They argue that by availing credit to the poor it would be possible to enhance their incomes and thereby improve the poor people's welfare.

Plate 1 Microfinance enables entrepreneurship

However many researchers feel that much of the enthusiasm about microfinance rests on a series of logical assumptions and almost no or few studies have been used to give empirical evidence on loan uses and other important welfare indicators for borrowers. Given this there is therefore need for more research to ascertain the real impact of microfinance on poverty (Zeller and Meyer. (2002) Sharma, (2000), Modurch (2000).

The main objective of the study is to analyze the costs both explicit and implicit of transacting business with a microfinance institution for poor rural borrowers. This analysis shall help us understand the consequences of such costs to borrowers' incomes, and livelihoods.

The study hypothesis is that, depending on individual household socioeconomic conditions, welfare Outcomes after a microfinance intervention may be different given that transactions costs, depend very much on individual socio economic conditions.

Methodology

The main data collection methods used for the study were participant observation, structured questionnaire and focus Group discussions.

Results and discussion

It was established that 43% of the poor will take the loans with a major objective of first meeting the basic needs, mostly providing food for the family with an intention of investing the remaining money.

% of poor borrowers	% of loan money used on food
1	100
5	75
37	25

Chart 1: Loan Uses by the poor

Misappropriation of resources is costly to livelihoods.

Method of Loan repayment	% of poor borrowers affected
Duress	60
Property confiscation by peers	4
Sale of pre-existing property	17
Incur other debts	2

Chart 2: methods of Loan repayment by the poor

In the process, 23% of borrowers will drop out of the borrowing group after their first loan has been repaid due to repayment pressure.

Plate 2: A small business for a rural poor woman

It is also costly to monitor the activities of other group members and to be financially prepared in case of their delay in repayment or complete non repayment.

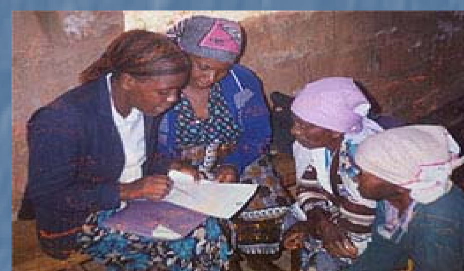

Plate 3: Peers in a borrowing group monitor each other to ensure loan repayment and scrutinise prospective members for their ability to pay

High transactions costs both implicit and explicit coupled with stringent repayment contracts may lead to depletion of pre-existing livelihood resources, stunted businesses due to undercapitalization and thereby more poverty or zero impact

Plate 4: Depletion of livelihood assets through stringent loan repayment contracts may lead to stunted businesses, Poverty and more suffering.

Conclusion

There is an incentive to avail more loans to the poor by microfinance institutions since the chances of non repayment have been minimised by way of stringent contracts. The poor have less bargaining power and given the asymmetry of information the poor loose through high explicit and implicit transaction costs.

There is therefore need to make more innovations so that transactions costs are reduced. One suggestion would be to find a way of innovative substantial insurance for microfinance loan; so as to partly shift the burden of non repayment from the poor to some third party. However further research is needed to establish an appropriate compromise between the interests of the borrowers and the financiers.

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