Chapter 16
Microfinance from LDCs to DCs: Are Socio–Economic Differences Important?

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ABSTRACT
Microfinance (MF) has demonstrated great success in poverty-relief in less-developed countries (LDCs) and is experiencing rapid growth and interest in developed countries (DCs). However, the current literature on DC MF leaves a general impression that DC MF is failing and its original core intent of poverty relief is being diluted by survival concerns. Descriptive analysis is used in this chapter to infer that DC MF must be redesigned to meet DC socio-economic conditions, if it is to avoid a reputation of being too poorly focused, ineffective, and inefficient for use in DCs. After demonstrating that poverty in LDCs is harsher than in DCs, this chapter reviews current-performance concerns of DC MF, discusses how it can still effectively relieve poverty in DCs, examines how regulatory and other socio-economic factors affect micro-enterprise, and concludes that MF should be refocused before DCs commit to further developing/adapting MF infrastructure.

INTRODUCTION
Microfinance (MF) has a long history of successful deployment in lesser developed countries (LDCs). However, MF has different meanings for different people and interest groups, that vary from micro-credit (for micro-enterprise development and consumer durables) to insurance and income protection, to social enlightenment (Burkett, 2003). This chapter corrals this diversity of meaning into a broad definition where MF is conceptualized as a set of tools, approaches and strategies developed in LDCs to give a hand-up to people who are trapped in poverty because, for various reasons, they are excluded from accessing mainstream financial services. Buckland & Dong (2008) note that financially excluded people (by definition) rely almost entirely on non-mainstream and informal financial services. The well-documented profound success of MF,
in helping many poor in LDCs escape the poverty trap, has sparked debate on how such powerful tools can be, or have been, imported to developed countries (DCs) for similar service—for details see Servon, 1997 and 2006; Bhatt & Tang, 2001; Hung, 2003; and Dubreuil & Mirada, 2008.

The literature on DC MF projects, as noted later in this chapter, gives the general impression that MF in DCs is failing to achieve both its financial and poverty-relief objectives. Many researchers attribute these difficulties to high administration costs, nonperforming and/or defaulted loans, adverse-selection of clients, cost-recovery issues, difficulty developing appropriate administrative tools (e.g. use of peer-groups), and confusion over its client base and role in society. However, the thesis in this chapter is that these issues are symptoms and that, unless the fundamental cause of these symptoms is resolved, the progression of DC MF setbacks will continue and likely turn to a general rejection of DC MF by fund providers and mainstream DC finance.

This chapter flows from the premise that a tool designed for a specific purpose and for use under specific conditions can fail catastrophically if it is applied toward a different purpose with different prevailing conditions. The objective of this chapter is to show that the root causes of poverty differ between LDCs and DCs and that those differences are important to the design and deployment of MF tools in DCs. This chapter is organized as follows:

1. A background discussion on how MF works, an evaluation of socio-economic differences between LDCs and DCs (in particular how poverty differs between them), a review of current performance concerns of DC MF, consideration of whether MF can be and/or is being adapted to effectively relieve poverty in DCs, and a conclusion that MF should be refocused before DCs commit to developing/adapting infrastructure for MF.

**BACKGROUND**

**How Does Microfinance Work?**

It is vital, from the outset, to understand that MF works best when it helps the poor surmount restrictions on their ability to access mainstream financial services and that lack of access was either holding them in poverty or putting them at risk of falling into poverty. A non-exhaustive selection of these **at-risk groups** in DCs, include those who are isolated by real or perceived attributes associated, among other things, with (see Table 1):

Thus, for MF to work in DCs: (1) difficulties in accessing mainstream-financial services must be a significant cause of DC poverty; (2) access problems of one or more at-risk groups must be targeted; and 3) the MF process must be sustainable. The absence of any or all of these attributes risks making DC MF an innovative variant of

### Table 1.

<table>
<thead>
<tr>
<th>Issue</th>
<th>Examples/description</th>
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<tbody>
<tr>
<td>Culture, ethnicity, or religion</td>
<td>European Gypsies, Australian Aborigines, Aboriginals in the Americas (e.g. the First Nations of Canada and Native American of the USA), multi-generational welfare families, and new migrants with language issues. Ageism (50+ or young adults) or sexism (often, but not always, female) are also common issues.</td>
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<tr>
<td>Educational challenges</td>
<td>Illiterate, innumerate, inarticulate, unskilled in a trade or a profession.</td>
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<tr>
<td>Poor employment prospects</td>
<td>Unaccredited and/or inexperienced in the work-force (often directly closely related to the educational challenges above).</td>
</tr>
<tr>
<td>Ill-health, disability, or disfig-</td>
<td>Mental or physical difficulties arising from disease, accident, age, or congenital issues.</td>
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<td>urement</td>
<td>Family obligations</td>
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<tr>
<td></td>
<td>Single parent households, the role of wife in a traditional extended family, adult children with disabled parent(s).</td>
</tr>
</tbody>
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