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RESEARCH ARTICLE

THE ROLE OF ENTREPRENEURSHIP IN REDUCING POVERTY

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ABSTRACT

This paper determines the role of entrepreneurship in poverty alleviation. The focus gears towards reducing vulnerability among the poor members of SHGs microfinance and the venture towards income generation. The study indicates the sustainability measures as well as the feasibility aspect in order to become successful in implementing micro-enterprises. The SHGs Bank Linkage model is considered as an effective tool in providing financial resources to the poor. Today entrepreneurship is the call of the time so that it will help develop the community and create more employment and better opportunities.

INTRODUCTION

Entrepreneurship is the active process of recognising an economic demand in an economy, and supplying the factors of production (land, labour and capital) to satisfy that demand, usually to generate a profit. High levels of poverty combined with slow economic growth in the formal sector have forced a large part of the developing world's population into self-employment and informal activities. But this is not necessarily negative; microenterprises contribute significantly to economic growth, social stability and equity. The sector is one of the most important vehicles through which low-income people can escape poverty. With limited skills and education to compete for formal sector jobs, these men and women find economic opportunities in microenterprises as business owners and employees. If successful, entrepreneurship is likely to result in a small- medium enterprise (SME). They include a variety of firms – village handicrafts makers, small machine shops, restaurants, and computer software firms – that possess a wide range of sophistication and skills, and operate in very different markets and social environments. In most developing countries, microenterprises and small-scale enterprises account for the majority of firms and a large share of employment. Finally, it has been noted that, "SMEs constitute the most dynamic segment of many transition and developing economies. They are more innovative, faster growing, and possibly more profitable as compared to larger-sized enterprises." Hence, the role of entrepreneurship in reducing poverty is promising. It has already been identified that entrepreneurship is a major contributing factor to economic growth, however, entrepreneurial ability and leadership tend to be relatively lacking in many institutions. Collier and Batty (pp. 491/492) have identified five primary reasons for the shortage of entrepreneurs in developing communities. Firstly, this includes the limited profit opportunities which exist in developing communities as a result of lower per capita incomes and limited markets. Secondly, poorly developed capital markets make it difficult for potential entrepreneurs to borrow the funds needed to establish new businesses and take advantage of new investment opportunities. This ties in closely with the role of microfinance in empowering entrepreneurship. Thirdly, poorly developed infrastructures hinder the development of new commodity and resource markets as well as inhibiting the efficient operation of existing ones. Fourthly, sometimes social, cultural and religious beliefs and attitudes attach little importance to monetary gain, restrict economic and social mobility, or assign very low status to entrepreneurs. And fifthly, an unfavourable economic and political climate might discourage the development of entrepreneurial talent and initiative. It is often argued that in light of these barriers, governments hold the key in opening doors to aspiring entrepreneurs. The government of India can play an important role in improving the quantity and quality of entrepreneurs in a number of ways. Collier and Batty (pp. 534/535) suggest a number of policies to reduce the shortage of entrepreneurs, such as the establishment of specialist educational institutions offering courses in business management and administration, and the establishment of specialist government agencies and departments to provide advice and assistance to local entrepreneurs about to take up a business venture are likely to aid the process. Additionally, tax relief, subsidies, investment allowances and other incentives may encourage entrepreneurial activities, similarly, the provision of credit facilities to finance appropriate new business ventures might help. And finally, the attempted maintenance of an economic, social and political climate, which is favourable to entrepreneurs, is essential. It has also been suggested that official policies often make business difficult for micro-entrepreneurs. Improved business regulations, tax regimes, licensing requirements, financial sector reform and bank supervision will promote better conditions for microenterprise development. A final optimistic suggestion, according to economic theory, implies that the income expenditure multiplier effect may also help to create chain reactions through developing economies, thus helping to break the cycle of poverty.

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The role of sustainability in reducing poverty

The concept of sustainability is difficult to define, and its precise definition varies within differing contexts. However, regarding the development process, two primary aspects of sustainability emerge: economic and environmental sustainability. Both tie in with the notion of sustainable micro-entrepreneurship; economic sustainability refers to a continual supply of finance to meet a person/community's needs, usually in the form of secure and accessible loans from a microfinance institution; and environmental sustainability is the aim to preserve environmental resources for use by future generations. Littlefield (2004) claims, "If you're going to provide financial services permanently to people, they've got to be sustainable, and that means charging interest rates that cover your costs." Similarly, the IFC (2004) notes, "Well-managed microfinance institutions…have convincingly demonstrated that they can become profitable and sustainable institutions while making major contributions to poverty reduction by increasing economic opportunities and employment." This is core to sustainable micro-entrepreneurship. Sustainable development bears relevance to the developing world, primarily due to the role of the private sector in reducing poverty (such as microfinance institutions, business organisations and multinational corporations). This affects them because the growing public awareness of corporate governance and of environmental and social issues is driving changes in consumer behaviour, investment, and policy or regulatory adjustments. All signs point to continued pressure on the private sector to demonstrate that economic growth and sustainability are compatible. In an examination of 'ordinary' businesses in LDCs, who have strategically integrated sustainability into their operations, it was noted that, "the evidence confirms that there are compelling commercial reasons to take action, despite a common assumption that sustainability is a luxury which emerging markets cannot afford."[22] Thus, economic and environmental goals may be pursued simultaneously, and it is now becoming apparent that this may be in firms' interests. Strategies exist to promote sustainable development in LDCs all over the world. However, it is argued that, "Sustainable development will only be achieved by ensuring that the economic, social, cultural and environmental dimensions of development be addressed in an integrated and balanced manner. This requires breaking down institutional and mental barriers between different sectors of society…" and in forging close cooperation between the sectors. However, there are challenges as well as opportunities in putting a greater emphasis on sustainability in emerging markets. Some may argue that the business case for sustainability does not apply in markets where incomes are low and mostly spent on basic needs, but also firms might not see benefits from improving environmental or social performance. Some social scientists argue that businesses resisting sustainable practices, may put themselves at a long-term competitive disadvantage by missing opportunities, such as economically efficient and environmentally sound production methods that allow new market entrants to produce for less. Such businesses may also face greater downside exposure to changes in the competitive environment and consumer behavior. Whereas non-sustainable operations were in the commercial interests of firms in the past, this may not be the case in the future, especially in the developing world, where efficiency and cleanliness are vital to the development process.

Case studies of microfinance, entrepreneurship and microfinance in reducing poverty

The growth in the microfinance industry over the last ten years has taken place in the absence of specific financial sector policies for microfinance. Today, about 40 million low-income entrepreneurs, mainly in the developing countries, have access to microfinance. In India, what began with a few small grants and loans from international donors, has now provided over 100 million dollars in loans. The most distinctive feature of the credit delivery system is the absence of middle men between the credit supplier and end user. The bank's cumulative recovery rate is an astounding 98 percent. The bank also aims to raise health and environmental consciousness. Each of its members must plant at least one sapling a year as part of an afforestation programme. Grameen is perhaps the only bank in the world that encourages birth control, sanitation and a clean environment as part of its lending policy. The Wall Street Journal (15 July, 1997) notes, "The real measure of its success is that BancoSol has spawned a slew of competitions." In India, despite the large size and depth of its financial system, the majority of the rural poor do not have access to formal finance and financial services. For this reason, innovative microfinance initiatives pioneered by nongovernmental organizations strove to create links between commercial banks, NGOs, and informal local groups to create the "SHG Bank Linkage". The success of SHG Bank Linkage has been largely attributed to good policy and strong leadership, in conjunction with facilitating government policy and legal framework. India's approach to microfinance – making it profitable and so widely available – helped the country reduce the incidence of poverty from about 40 percent of the population in the mid-1970's to about 11 percent in 1996 (Robinson, 2002). Members of SHG recognise that "several challenges lie ahead," but still believe it has "the right ingredients to be scaled-up into offering mass access to finance for the rural poor while improving sustainability." (World Bank, 2003)

Reaching the Unreached Sectors

Microfinance industry is set to reach new heights. With superlative growth numbers in a period of economic downturn, the sector has come to attention of a wider range of investors. Despite the widespread liquidity crunch, the SHG-bank linkage and the group lending microfinance institution (MFI) models recorded impressive increase both in terms of number of households reached and volume of loans. During the year 2008-09 6.9 million new members were added under SHG model taking the total membership tally to 54 million. In recent trends, MFIs added 8.5 million new members, taking the total client base to 22.6 million. The total outstanding microfinance loans including credit to SHGs by banks amounted to Rs.359.39 billion as on March 2009: a growth of 30% over last year. By the end of March 2009, these numbers in combination constituted 1.29% of gross bank credit of scheduled commercial banks1. However the regional bias still exists: the north and eastern India are still largely underserved, and many areas in the north and north-east regions remain entirely untouched and likely explored. The deeper penetration in new and existing areas has opened many organisations to new and diverse risks. These risks come in the form of multiple lending, large loan size disbursement in poorer markets, migration of borrowers and so on. These risks are further exacerbated by the fact that, with the focus on achieving numbers, poaching of groups and multiple lending has become common within Indian microfinance. Sporadic warning signs have been seen in south where concerted resistance from clients to making repayments in the face of multiple loans is growing. The standardised lending systems, loan amounts, and weekly meetings/repayments can create problems for clients' business (due to inappropriate loan sizes and terms) and domestic problems (due to the repeated group meetings) and in some cases overwhelming debt. The Kolar standoff in Karnataka generated international headlines and showed that outside intervention of this form could yet disrupt the growth and development of the industry.

The Commercialism of Microfinance

The sector continues to see many not for profit MFIs transforming to become for profit Non Bank Financial Corporation's (NBFCs). This move has been driven by the need to raise additional debt (which is readily available from commercial banks seeking to meet their priority sector lending requirements) and, in some cases at least, a desire to make profits. The NBFC legal form allows banks to lend to MFIs with greater confidence, and the MFIs to attract outside equity and thus leverage still greater debt. Microfinance and other financial sectors offer venture capital/private equity (PE) funds and the MFIs' promoters an opportunity to seek substantial capital returns1 – despite India having some of the most efficient MFIs, offering services at

some of the lowest interest rates in the world. Amid the heated discussion surrounding interest rates in India, the importance of generating positive returns to underpin sustainable growth, and thus expand financial inclusion is often lost amid the passion and rhetoric.
Given the growth and maturity dynamics, the sector has become a viable investment option with commercial investors overwhelming the investments made by patient social investors. This is reflected in the high equity valuations that the sector has experienced, and corroborating this fact was reflected in the large PE investments made in MFIs. The investments increased by over $380 million2 in the six year period between January 2004 and December 2009, with almost 88% of this equity flowing in last two years. This investment reflects 7% of the entire investment in banking financial services and insurance (BFSI) sectors. The profit-focused equity investments, together with the growth of specialised financial service providers like IFMR Capital and Grameen Capital India, have increased, diversified and deepened MFIs' links with the formal financial sector. Many large and increasingly sophisticated deals including a variety of forms of securitisation, non convertible debentures (NCD), commercial paper, purchase of loan books and subordinated debt-based lending have already been completed, and IPOs are anticipated from SKS and at least 3-4 other of the larger NBFCs. Most IPOs are the preferred exit route for many of the PE investors – and, if SKS's model is followed, also for the MFI's promoters3. Indeed, today an IPO is the inspiration and ambition for a growing number of MFIs and their promoters. Valuations seem to be likely to follow a telco-based model and thus based on the number of clients on an MFI's books – resulting in huge incentives to rollout and hard-sell standardised products without reference to the needs (or other debts) of the clients. Small wonder there is chorus of concern about the future and direction of microfinance in India. The increased size and profile of the financial service sector and micro finance sector in particular has also stimulated the Reserve Bank of India (RBI) into action. In the midst of global liquidity crisis in 2008, the RBI increased the CAR - the ratio of capital to risk weighted assets - for NBFCs MFIs from 10% to 12% by March 2009. This requirement is expected to grow to 15%, and other measures may be looming as RBI and the Ministry of Finance display increasing discomfort with the direction the microfinance industry is taking.

Life Cycle Needs

The growth and competition in MFI industry, has been accompanied by limited creation of new products and services to address other unmet needs of MFIs' clients. Where offered, the services are extended either directly or by acting as a bridge between third party providers – saving, remittances, and micro insurance. With the global attention on financial inclusion, savings services have come into the spotlight. In the two years from 2007, the number of SHGs with saving accounts at formal sector banks has grown by 44% to 5.99 million. The balance in these accounts has increased to Rs.54.47 billion in March 2009 - a growth of 55% over the 2007 numbers1. Much work has also been done under the business correspondent channel of the banks (see next section). Some MFIs have started to work on individual lending products. Developing effective individual lending programmes is complex and time-consuming4 – and is not for those focused on rapid growth5. Nonetheless, as the Indian microfinance market matures MFIs will need to develop new products and services to retain their customers in the face of competition.

Banking and Business Correspondent

Technology is set to revolutionise the sector – but the potential still remains to be realised. Pilots are on-going to test the use of biometrics, smart card and mobile devices to offer saving, remittance and insurance services and to test mobile-based MIS. All are aimed to reduce costs and improve the reliability of operations in the field. These innovative uses are being encouraged and facilitated by the RBI slowly liberalising the regulations governing the appointment of business correspondents (BC) to provide banking services to the unbanked. In addition to allowing merchant establishments, insurance agents, retired teachers etc. to act as BCs for the banks, the RBI recently announced that it would allow trial of "reasonable fees" levied from the end users of the service. Indian Banks seem unsure how to respond to this offer, but it is likely that once SBI or one of the other larger scheduled commercial banks has defined what is reasonable as a fee, others will quickly follow. Despite all the work, many challenges remain to be addressed. The total number of no frills account opened between April 2007 and May 2009 was 25.15 million, of which only 11% (2.77 million) are operational6. The government has now started routing welfare payments through the "No Frills" saving accounts, and encouraging the banks to put technology in place and to use MFI channels to serve customers. This, it is hoped, will stimulate financial inclusion and reduce the "leakage" and corruption in more traditional approaches to distributing welfare payments.

Enterprise Performance Management

The push for growth, increasing competition, increasing over-indebtedness of clients, aggressive collection practices and the entry of investors (both social and commercial) looking for returns have brought Enterprise Performance - or putting mission into practice - into focus. Some MFIs have started, with varying degrees of conviction, to review their emphasis on the social and financial bottom lines. However, Enterprise Performance Management (SPM) has remained largely focused on the poverty levels of clients served rather than the quality of services provided to those clients – to the valuation process of the clients and the MFIs serving the SHGs in developing communities.

Conclusion

The economic benefits of sustainable micro-entrepreneurship in developing communities are compelling, and its potential effects on the development process are equally promising. In terms of development and social impact, the microfinance industry allows significant improvements in quality of life for the micro-entrepreneurs around the world. They can now stabilise the cash flow of their economic activity, bringing security to the enterprise. This allows them to better manage spending, which often generates savings; and this provides better standards of living to their family, and dependents in terms of housing, nutrition, health and education. Finally, an access to banking and increased security promotes a sense of entrepreneurship, and thus their self-esteem and reputation increase. The initial small loan of usually less than $100 can eventually reintegrate these entrepreneurs into formal networks of the economy and foster the structural and sustainable development of local communities. Furthermore, estimates indicate that today only 5% of the micro-credit demand is fulfilled, thus, the microfinance industry is expected to grow significantly in coming years. Despite several challenges ahead, this emerging industry, and the process of sustainable micro-entrepreneurship combine to offer a potential alleviation solution to the poverty crisis of the 21st century, and into a sustainable future.

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