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Micro Finance: An effective tool for poverty Reduction

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Abstract: **Indian population comprises approximately one sixth of the world's population. Among this, ten percent of the population possesses a large proportion of the total wealth of India. There is a wide gap exists between the rich and the poor in India. During the past few years, India has demonstrated a welcome willingness to innovate and to think afresh about financial services to alleviate poverty. The poverty reduction has become the object of unprecedented attention at national and international level. The Scheme of Micro-finance has been found as an effective instrument for lifting the poor above the level of poverty by providing them increased self-employment opportunities and making them credit worthy. Thus the concept of micro finance gained growing recognition as an effective tool in improving the quality of life and living standards of poor people. This paper attempts to provide a critical appraisal of the debate on the effectiveness of microfinance as a universal poverty reduction tool. It argues that while microfinance has developed some innovative management and business strategies, its impact on poverty reduction remains in doubt. Microfinance, however, certainly plays an important role in providing safety-net and consumption smoothening.**

Keywords: **Microfinance, Poverty, Growth, Employment.**

1. INTRODUCTION

In India more than 70% of the population lives in villages and most of these villages are underdeveloped. Research and development sector in our country brings number strategies in favour of these people every year. Implementation of these technologies in the rural sector can alleviate poverty, create employment opportunities and generate good growth. However, for implementing these technologies micro financing through public and private sector agencies is the need of the hour.

Micro-finance economically disadvantaged segments of society, for enabling them to raise their income levels largest in term of population after China. India's GDP ranks among the top 15 economies of the world. However, around 300 million people or about 80 million households are living below the poverty line, i.e. less than $2 per day according to the World Bank and the poorest are which earns $1 per day. It is further estimated that of these households, only about 20% have access to credit from the formal sector. Out of these 80 million house hold, 80% takes credit from the informal sources i.e. local Zamidars, Chit Funds etc. With about 80 million households below MFIs include non- governmental organizations (NGOs), credit unions, non-bank financial intermediaries, and even a few commercial banks.

In India, a substantial microfinance system based on self help groups (SHGs) was developed. It allows poor people to protect, diversify and increase their sources of income, the essential path out of poverty and hunger. As a developmental and economic tool it has caught the imagination of banks, financial institutions and NGOs in India. Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities enable the poor to smoothen their consumption, manage their risks better, build their assets gradually and develop their micro enterprises. Government, NGOs and other financial institutions have introduced various welfare schemes and activities to reduce poverty. Microfinance, by providing small loans and savings facilities to those who are excluded from commercial financial services has been developed as a key strategy for reducing poverty throughout the world.

A Profile of Rural India

- 350 million Below Poverty Line
- 95 % have no access to microfinance.
- 56 % people still borrow from informal sources.
- 70 % don't have any deposit account.
- 87 % no access to credit from formal sources.
- Annual credit demand is about Rs.70,000 crores.
- 95 % of the households are without any kind of insurance.
- Informally Microfinance has been in practice for ages.

Rural India and Microfinance

Government‘s initiative to reduce poverty by improving access to financial services to poor started since independence. India’s overwhelming majority of poor is located in rural areas and this motivated the government to give special attention to rural credit. Following the report of All India Rural Credit Survey in mid 1950‘s, the State took crucial steps in reviewing Cooperative structure including the partnership of State in cooperatives. Also the policy initiative of ‗social banking‘concept described as ―the elevation of the entitlements of previously disadvantaged groups to formal credit even if this may entail a weakening of the conventional banking practices‖ led to the nationalization of commercial banks in 1969, adoption of direct lending programmes to rural areas and development of credit institutions such as Regional Rural Banks (RRBs). Government initiatives during the Fourth Plan focused on marginal farmers and agricultural labourers bringing individual family as the basic borrowing unit. Integrated sustainable income generating activity was promoted through subsidized lending under Integrated Rural Development Programme (IRDP) and its subsequent variations including the current self-employment programme known as Swaranjayanti Gram Swarozgar Yojana (SGSY).

2. INDIAN MICROFINANCE SECTOR

Indian microfinance sector is expected to grow nearly ten times by 2011 to a size of about Rs250 billion from the current market size of Rs27 billion, at a compounded annual growth rate of 76%. Microfinance in India started evolving in the early 1980s with the formation of informal Self Help Group (SHG) for providing access to financial services to the needy people who are deprived of credit facilities. National Bank for Agriculture and Rural Development, the regulator for microfinance sector, and Small Industries Development Bank of India are devoting their financial resources and time towards the development of microfinance. Microfinance has enormous growth potential as half the world‘s population earns less than US$2 per day, which is insufficient to meet their basic needs. One of the fastest growing sectors of India, microfinance is spearheading intense competition among the largest players. By the end of March 2009, microfinance institutions expanded their outreach to 50 million households and about 38 million borrowers. These institutions are organized under three models: SHG, Grameen model/Joint liability groups and Individual banking groups as in cooperatives. As of March 2009, both SHG bank linkage and MFIs have collectively disbursed US$3.9 billion to the poor.

Table-1: State-wise position of MFIs

State-wise position of MFIs		
Sl.No	**No. Of MFIS**	**Share%**
Andhra Pradesh	484	62
Bihar	44	6
Gujarat	8	1
Jharkhand	1	0
Karnataka	20	3
Kerala	18	2
Madhya Pradesh	14	2
Maharashtra	15	2

Orissa	28	4
Rajasthan	18	2
Tamil Nadu	101	13
Uttar Pradesh	5	1
West Bengal	30	4

Source: NABARD

TYPES OF MF PROVIDERS

The different legal forms under which MF can be provided in India are:

1. Commercial Banks

2. Cooperative Banks

3. Regional Rural Banks (RRBs)

4. Local Area Banks (LABs)

5. Cooperative Societies, SHGs and Federations

6. Societies

7. Trusts

8. Section 25 (Not-for-Profit) companies

9. Non-Banking Finance Companies (NBFCs)

10. Organizations under Business Facilitator/Business Correspondent guidelines of the Reserve Bank of India

Among these, the MFIs can either take up the form of a Society, Trust, Co-operative Society, or NBFC. There is no centralized database on the number of microfinance institutions that operate in the country; however, estimates have put it anywhere between 800 and 1,200. The overwhelming majority of MFIs are societies and trusts, followed by cooperative and section 25 companies. Among the large MFIs, most are NBFCs. It is estimated that top 20 MFIs account for 80% of the total portfolio.

3. ROLE OF MICRO FINANCE INSTITUTIONS

1. Poverty reduction tool

Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smooth their consumption, manage their risks better, build their assets gradually, and develop their micro enterprises. Microfinance is only a means and not an end. The ultimate goal is to reduce poverty. Government, NGOs and other financial institutions have introduced various welfare schemes and activities to reduce poverty. Microfinance, by providing small loans and savings facilities to those who are excluded from commercial financial services has been developed as a key strategy for reducing poverty throughout the world.

2. Women Empowerment

In rural areas women living below the poverty line are unable to realize their potential. Microfinance programmes are currently being promoted as a key strategy for simultaneously addressing both poverty alleviation and women‘s empowerment. The self help groups (SHGs) of women as sources of microfinance have helped them to take part in development activities. The participation of women in SHGs made a significant impact on their empowerment both in social and economic aspects. Vast sections of the rural poor are even now deprived of the basic amenities, opportunities and oppressed by social customs and practices. Several programmes were implemented by various governments and nongovernmental organizations to uplift them both economically and socially. It has been an accepted premise that women were not given enough opportunities to involve themselves in the decision making process of the family as well as in the society. Hence, women were the main target groups under SHG programme. Microfinance can provide an effective way to assist and empower poor women, who make up a significant proportion of the poor and suffer disproportionately from poverty.

3. Self Employment

Poverty reduction through self employment has long been a high priority for the Government of India. Microfinance is an experimental tool in its overall strategies. Most of poor people manage to optimize resources over a time to develop their enterprises. Financial services could enable the poor to leverage their initiative, accelerating the process of generating incomes, assets and economic security. However, conventional finance institutions seldom lend down-market to serve the needs of low-income families and women-headed households. Therefore fundamental approach is to create the self employment by financing the rural poor through financial institutions. Microfinance, thus, creates the hope and increases the self-esteem of the poor by giving the opportunities to be employed.

4. Development of the overall financial system

Without permanent access to institutional microfinance, most poor households continue to rely on meager self-finance or informal sources of microfinance, which limits their ability to actively participate in and benefit from the development opportunities. Microfinance can contribute to the development of the overall financial system through integration of financial markets. Microfinance institutions (MFIs) can be small and medium enterprises at the heart of rural sustainable development. Their development positively correlates with rural business development.

5. SHG-bank linkage programme

Indian micro finance is dominated by the operational approach Self-help Groups (SHGs). The approach is popularly known as SHG-Bank linkage model. This model is the dominant model, initiated by the NABARD in the early 1990s. Today the SHG model also links the informal groups of women to the mainstream system and it has the largest outreach to micro financial clients in the world. SHGS comprise a group of 15-20 members. The groups begin by savings that are placed in a common fund. In a way,

SHGs are co-operative (credit) societies linked to a commercial bank rather than an apex cooperative bank. Once linked to the bank, the SHGs may access a given multiple of the pooled savings for disbursement to its members. The SHG-bank linkage programme was conceived with the objectives of supplementary credit delivery services for the un-reached poor, building mutual trust and confidence between the bankers and the poor and encouraging banking activity both on thrift as well as credit and sustaining a simple and formal mechanism of banking with the poor. The linkage programme combines the flexibility, sensitivity and responsiveness of the informal credit system with the technical and administrative capabilities and financial resources of the formal financial sector which rely heavily on collective strength of the poor, closeness of effective social mobilization functions contributing to an overall empowerment process.

In India, economic reforms with a human face have been accepted as the guiding principle of sustainable development. Keeping the poor at center stage, the policies need to be reoriented so as to develop and optimize the potential of such a large segment of the population and enable them to contribute in the growth process significantly in terms of output, income, employment and consumption. Viewed form this angle, our survey results show that

- Micro-Finance can be a powerful instrument initiating a cyclical process of growth and development.
- Micro-Finance activity improved access of rural poor to financial services, both savings and credit.
- Increased access signifies overcoming isolation of rural women in terms of their access to financial services and denial of credit due to absence of collateral.
- The pool of savings generated out of very small but regular contributions improved access of the poor women to bank loans.
- It could also help in strengthening poor families' resistance to external shocks and reducing dependence on moneylenders.
- The observed support for consumption smoothening would not have been possible, but for the SHGs internal support
- The predominance of borrowing for crop cultivation reflects support for meeting working capital needs.
- Possibilities could be of explored for using SHGs as a strong conduit for purveying crop cultivation loans to very small and marginal farmers to step up crop loan finance.

4. CONCLUSION

Rural development and poverty reduction are commonly related to the issue of rural employment. Rural households livelihood strategies comprise several options, including farming and non-farm activities, local self-employment and wage employment, and migration. Microfinance has proven to be an effective and powerful tool for rural development and poverty reduction. Like many other development tools, it has sufficiently penetrated the poorer strata of society. The poorest form the vast majority of those without access to primary health care and basic education; similarly, they are the majority of those without access to microfinance. Micro-finance is one of the ways of building the capacities of the poor and devloping them to self-employment activities by providing financial services like credit, savings and insurance. To provide micro-finance and other support services, MFIs should be able to sustain themselves for a long period. There are so many schemes for the development of poor In India. Creating self employment opportunities through micro finance is one way of attacking poverty and solving the problems of unemployment. In India, the micro finance movement has almost assumed the shape of an industry, embracing thousands of NGOs/MFIs. During the last decade, the sector has witnessed a sharp growth with the emergence of a number of Micro Finance Institutions (MFIs) providing financial and non-financial supports to the poor in an effort to lift them out of poverty. There are over 1,000 Indian MFIs. These institutions assume the responsibility of making available much needed micro credit to the poor section of the society for generating the self employment The MFI channel of credit delivery, coupled with the national level programme of SHG-Bank Linkage, today, reaches out to millions of poor across the country.

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