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Role of Micro Finance in Poverty Reduction

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Abstract: **Micro finance has proven to be an effective tool for poverty reduction. Microfinance is the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services. More broadly, it is a movement whose object is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers." Those who promote microfinance generally believe that such access will help poor people out of poverty. The dynamic growth of the microfinance industry has been promoted not only by market forces but also by conscious actions of national governments, Non-Governmental Organizations (NGOs) and the donors who view microfinance as an effective tool for eradicating poverty. The powerful push behind this huge and increasing support for microfinance indicated that national economic and social impacts are significant and it needs to be examined more closely. This paper argues that microfinance can be considered an important element for an effective poverty reduction strategy. It shows that access and efficient provision of microcredit can enable the poor to smooth their consumption, manage their risks better, gradually build their assets, develop their micro enterprises, enhance their income earning capacity and enjoy an improved quality of life. Microfinance services can also contribute to the improvement of resource allocation, promotion of markets, and adoption of better technology; thus, microfinance helps to promote economic growth and development.**

Keywords: **Micro Finance, Micro credit, Financial Services, Poverty, NGOs, India**

I. INTRODUCTION

Across the world almost every country has to face the poverty. Poverty is the condition in which low-income people cannot meet the basic needs of life. This situation leads to many fold difficulties like decreased health facilities, high illiteracy rate, decreased quality of life etc., these difficulties motivate human beings to commit heinous crimes and times suicide. Poverty is defined as a situation of having no enough money to meet the basic need of human beings. Because poor people do not have direct access to bank .They need finance for meeting their routine and contingency need. These needs are fulfil by providing cheap finance at easy terms. This finance is called microfinance.

Microfinance is the provision of financial services to low income clients or solidarity lending groups including consumers and the self employed, who traditionally lack access to banking and related services .Microfinance is not just about giving micro credit to the poor rather it is an economic development tool whose objective is to assist poor to work their way out of poverty. It covers a wide range of services like credit, savings, insurance, remittance and also non financial services like training, counselling etc.

Microcredit emphasizes the provision of credit services to low income clients, usually in the form of small loans for micro enterprise and income generating activities. Use of the term 'microcredit' is often associated with an inadequate amount of the value of savings for the poor. In most cases, the provision of savings services in 'microcredit' schemes simply involves the collection of compulsory deposit amounts that are designed only to collateralize those loans. Additional voluntary savings may collect but the clients have restricted access to their enforced savings. These savings become the main source of capital in the financial institutions.

Microfinance refers to a variety of financial services that target low-income clients, particularly women. These services include loans, savings, insurance, and remittances. Microloans are provided for productive purposes. Productive purposes means, money given to clients as loan for investment in income generation activities such as businesses, livestock or any other activity, which has the potential to yield income for the client. Different products and services offered reflects the fact that the financial needs of individuals, households, and enterprises can change significantly over time, especially for those who live in poverty. Because of these varied needs, and because of the industry's focus on the poor, microfinance institutions often use non-traditional methodologies, such as group lending or other forms of collateral not employed by the formal financial sector.

In other words: - Micro finance is the

1. Provisional of financial services

2. to the poor people

3. Who do not have direct access to the banks

"Micro finance is the banking for poorer"

II. FEATURES OF MICROFINANCE

- Borrowers are from the low income group
- Loans are of small amount – micro loans
- Short duration loans
- Provide credit for investor in small scale activities chosen by the poor people
- Empower the poor to build self confidence that I can do something
- Can pay for itself with the interest earned
- Allow to develop opportunity for self employ to the understand people
- Have the broadest utility and the least cost per beneficiary
- Loans are taken for income generation purpose
- Loans are offered without collaterals
- High frequency of repayment

III. PRINCIPLES OF SUSTAINABLE DEVELOPMENT OF MICROFINANCE

Principle 1: Offer services that fit the preference of low income people

- Give short-term loans
- Give small loans
- Give repeat loans
- Allow relatively unrestricted use
- Be customer friendly

Principle 2: Streamline Operations to Reduce Costs

- Highly streamline operations
- Standardize the lending process
- Decentralize loan approval
- Maintain inexpensive offices
- Select staff from local communities

Principle 3: Motivate Clients to Repay Loans

- Do not require formal collateral
- Use character references or group lending with joint liability to motivate repayments
- Use incentives for prompt repayment
- Develop a public image that signals seriousness about loan collection

Principle 4: Charge Full-Cost Interest Rates and Fees

- Recover the costs of the loan. Small loan sizes and personalized service result in costs per loan that require interest rates significantly higher than commercial banks (although significantly lower that informal sector rates).
- Expect repayment. Low income entrepreneurs have shown a willingness and ability to pay interest rates higher than commercial banks for services that fit their needs.

IV. CHANNELS OF MICRO FINANCE

In India microfinance operates through two channels:

- SHG – Bank Linkage Programme
- Micro Finance Institution

SHG – Bank Linkage Programme

This is the bank led microfinance channel which was initiated by NABARD in 1992. Under the SHG model the members usually women in villages are encouraged to form groups of around 10 – 15. The members contribute their savings in the group periodically and form these savings small loans are provided to the members. In the later period these SHGs are provided with bank loans generally for income generation purpose. The group's members meet periodically when the new savings come in. Recovery of past loans is made from the members and also new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular. The SHGs are self sustaining and once the group becomes stable it starts working on its own with some support from NGOs

Micro Finance Institutions

Those institutions which have microfinance as their main operation are known as micro finance institutions. A number of organizations with varied size and legal forms offer microfinance services. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individually or through the group mechanism against a mutual guarantee. The reason for existence of separate institutions i.e. MFIs for offering microfinance are as follows:

- High transaction cost – generally micro credits fall below the break – even point of providing loans by banks
- Absence of collaterals – the poor usually are not in a state to offer collaterals to secure the credit
- Loans are generally taken for very short duration periods
- Higher frequency of repayment of instalments and higher rate of defaults

Non Banking Financial Companies (NBFCs), Co-operatives societies, Section-25 companies, Societies and Trusts, all such institutions operating in microfinance sector constitute MFIs and together they account for 42 percent of the microfinance sector in terms of loan portfolio.

V. ROLE OF MICROFINANCE IN POVERTY REDUCTION

Microfinance is about providing financial services to the poor who are not served by the conventional formal financial institutions - it is about extending the frontiers of financial service provision. The provision of such financial services requires innovative delivery channels and methodologies. The needs for financial services that allow people to both take advantage of opportunities and better management of their resources. Microfinance can be one effective tool amongst many for poverty alleviation. However, it should be used with caution -despite recent claims, the equation between microfinance and poverty alleviation is not straight-forward, because poverty is a complex phenomenon and many constraints that the poor in general have to cope with. We need to understand when and in what form microfinance is appropriate for the poorest; the delivery channel, methodology and products offered are all inter-linked and in turn affect the prospect and promise of poverty alleviation.

Access to formal banking services is difficult for the poor. The main problem the poor have to take when trying to acquire loans from formal financial institutions is the demand for collateral asked by these institutions. In addition, the process of acquiring a loan entails many bureaucratic procedures, which lead to extra transaction costs for the poor. Formal financial institutions are not motivated to lend money to them. In general, formal financial institutions show a preference for urban over rural sectors, large-scale over small scale transactions, and non-agricultural over agricultural loans. Formal financial institutions have little incentives to lend to the rural poor for the following reasons.

❖ ***Administrable difficulties:***

Small rural farmers often live geographically scattered, in areas with poor communication facilities, making loan administration difficult.

❖ ***Systematic risks:***

Agricultural production is associated with some systemic risks, such as drought and floods, which is reflected in a high covariance of local incomes.

❖ ***Lack of information:***

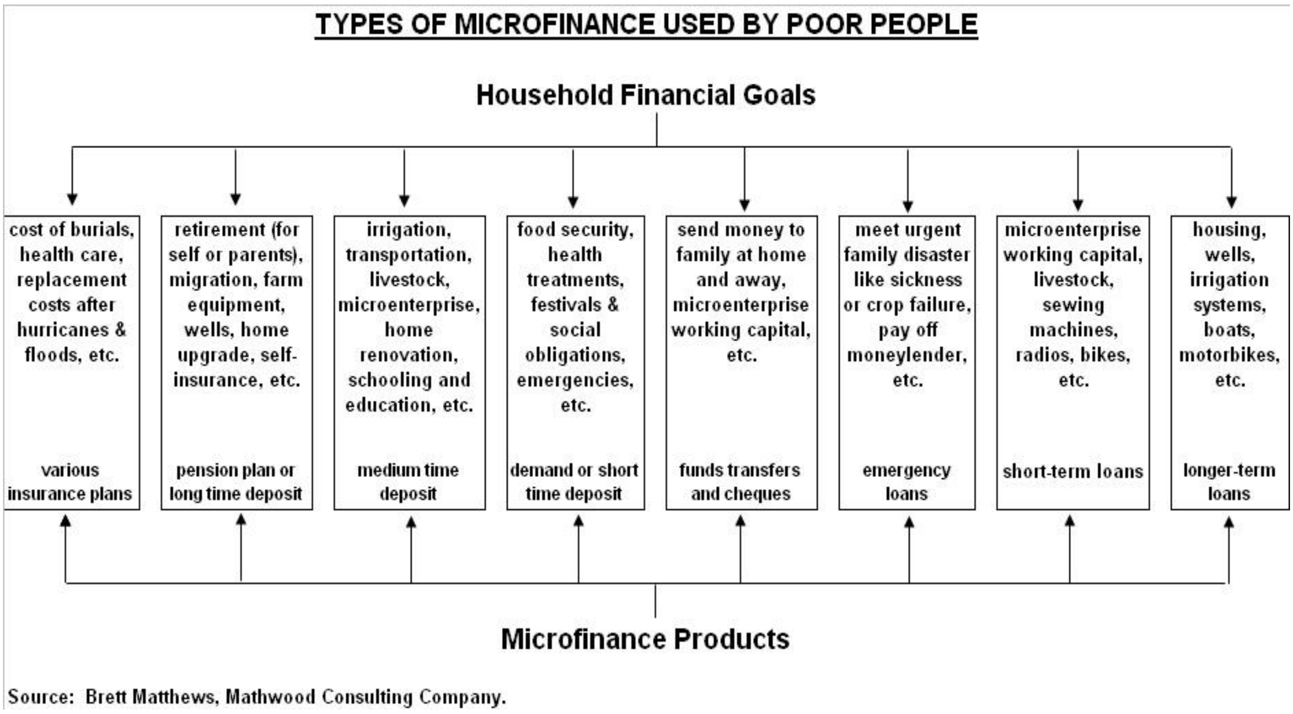
The absence of standardized information, Standard lending tools, such as financial statements or credit histories, does not exist in these areas.

❖ ***Repayment problems:***

The repayment of working capital may be required only once a year for example during the harvest season. On the other hand, access to informal loans is relatively easy, convenient, and available locally to low income households for the following reasons:-

- Informal moneylenders use interlinked credit contracts to reduce default risk such as development of business relationship with the clients.
- Informal moneylenders have local information which helps them to appraise credit needs and credit worthiness of the client.
- Informal moneylenders are considering the needs and requirements of clients even for small amount of loan.
- Informal money lenders will profit from social sanctions such as those that may exist among members of a family. These sanctions may serve as a substitute for legal enforcement.
- Informal moneylenders use specific incentives to stimulate repayment, such as repeat lending to borrowers who repay promptly, with gradually increasing loan size.

Despite the fact that many rural poor acquire their loans from the informal financial sector in rural areas of developing countries; the sector has some basic limitations. A common feature of many rural communities is that much of the local information does not flow freely; it tends to be segmented and circulates only within specific groups. Usually the informal credit market is based on local economies and is thus limited by local wealth constraints and the covariant risks of the local environment. Since most of the world's poor do not have access to basic financial services that would help them manage their assets and generate income. To overcome poverty, they need to be able to borrow, save, and invest, and to protect their families against adversity. Another shortcoming of the two financial sectors in developing countries is their inability to satisfy the credit needs of the poor that has led to the new development of microfinance. Microfinance is believed to be able to reduce the above-mentioned inadequacies of formal and informal financial institutions and is emerging as an important credit partner to the poor in the developing world.



VI. GOVERNMENT SCHEME FOR POVERTY REDUCTION

There are so many schemes for the upliftment of poor In India. One of them Micro-credit programmes is run primarily by NABARD in the field of agriculture and SIDBI in the field of Industry, Service and Business (ISB). The success of Micro-credit programme lies in diversification of services .Micro Finance Scheme of SIDBI is under operation since January, 1999 with a corpus of Rs. 100 crore and a network of about 190 capacity assessed rated MFIs/NGOs .Under the programme, total amount of Rs. 191 crore have been sanctioned up to 31st December, 2003, benefiting over 9 lakh beneficiaries. Under the programme, NGOs/ MFIs are supposed to provide equity support in order to avail SIDBI finance. But they find it difficult to manage the needed equity support because of their poor financial condition. The problem has got aggravated due to declining interest rate on deposits. The office of the development commissioner (Small Scale Industries) under Ministry of SSI is launching a new scheme of Micro Finance Programme to overcome the constraints in the existing scheme of SIDBI, whose reach is currently very low. It is felt that Government's role can be critical in expanding reach of the scheme, ensuring long term sustainability of NGOs /MFIs and development of Intermediaries for identification of viable projects.

VII. FEATURES OF MICRO-FINANCE PROGRAMME OF GOVERNMENT OF INDIA

a) Arranging Fixed Deposits for MFIs/NGOs:

Under this scheme government of India arrange money to MFI/NGO like SIDBI for micro credit to poor.

b) Training and Studies on Micro-Finance Programme:

Government of India would help SIDBI in meeting the training needs of NGOs, SHGs, intermediaries and entrepreneurs and also in enhancing awareness about the programme. Institution building for 'intermediaries' for identification of viable projects: The Government of India would help in institution building through identification and development of 'intermediary organization', which would help the NGOs/SHGs in identification of product, preparation of project report, working out forward and back ward linkages and in fixing marketing/ technology tie-ups. The SISIs would help in the identification of such intermediaries in different areas.

c) Budgetary Provision for the Scheme During 10th plan:

There was a budgetary provision in 10th five year plan and hoping more funds in next plan.

d) Administrative arrangement:

A committee has been formed to control and monitor the administrative arrangement of MFI/NGOs.

VII. CONCLUSION

Microcredit and microfinance have received extensive recognition as a strategy for poverty reduction and for economic empowerment. Microfinance is a way for fighting poverty, particularly in rural areas, where most of the world's poorest people live. Accessing small amounts of credit at reasonable interest rates give poor people an opportunity to set up their own small business. Many studies show that poor people are trustable, with higher repayment rates than conventional borrowers.

When poor people have access to financial services, they can earn more, build their assets, and cushion themselves against external shocks. Poor household's use microfinance to move from everyday survival to planning for the future: they invest in better nutrition, housing, health, and education. Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recoveries not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. A financially sustainable institution can continue and expand its services over the long term. Achieving sustainability means lowering transaction costs, offering services that are more useful to the clients, and finding new ways to provide banking services to the poor .At the end it should be mentioned that Poor people with no income or means of repayment need other kinds of support before they can make good use of loans. In many cases, other tools will alleviate poverty better—for instance, small grants, employment and training programs, or infrastructure improvements .Where possible, such services should be coupled with building savings. It shows that access and efficient provision of microcredit can enable the poor to smooth their consumption, better manage their risks better, gradually build their assets, develop their micro enterprises, enhance their income earning capacity and enjoy an improved quality of life. Microfinance services can also contribute to the improvement of resource allocation, promotion of markets, and adoption of better technology; thus, micro finance helps to promote economic growth and development.

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