Micro Finance in India- for Poverty Reduction

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Abstract -Microfinance is generally defined as financial services for poor and low-income clients.

Microfinance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group.

In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking.

Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Microcredit is one of the aspects of microfinance and the two are often confused the Microfinance revolution in India as a powerful tool for poverty alleviation. Where institutional finance failed Microfinance delivered, but the outreach is too small. There is a question mark on the viability of the Microfinance Institutions. There is a need for an all round effort to help develop the fledgling Microfinance Industry while tackling the trade-off between outreach and sustainability. The paper argues for mainstreaming impact assessment in evaluation of programmes for realizing the full potential of microfinance in achievement of Millennium

Development Goals (MDGs). Government of India considered micro finance is the major tool for reducing the poverty and support to the lower income people for self employment.

Microfinance in India- for Poverty Reduction

INTRODUCTION

Micro finance is emerging as a powerful instrument for poverty alleviation in the new economy. Beyond the direct linked with poverty reduction, it is an indirect link to address the issues of health, education and gender. Micro finance cover not only consumption and production loans, but will also include other credit needs such as housing and shelter improvements. Women constitute a vast majority of users of micro-credit and savings

services. The different organizations in the field of micro finance can be classified as “Mainstream” and “Alternative” Micro Finance Institution. National Agricultural Bank for Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), Housing Development Finance Corporation (HDFC), Commercial Banks, Regional Rural Banks, the credit cooperative societies etc., are some of the mainstream financial institutions involved in extending micro finance. On the other hand, institutions have come up to fill

the gap between the demand and supply for micro finance. Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women’s Association (“SEWA”) of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganised sector in Ahmadabad City, Gujarat. The microfinance sector went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. From humble beginnings, the sector

has grown significantly over the years to become a multi-billion dollar industry, with bodies such as the Small Industries Development Bank of India and the National Bank for Agriculture and Rural Development devoting significant financial resources to microfinance. Today, the top five private sector MFIs reach more than 20 million clients in nearly every state in India and many Indian MFIs have been recognized as global leaders in the industry.

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.

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. 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.

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 microenterprises. 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. Development of the overall financial system

Without permanent access to institutional microfinance, most poor households continue to rely on meagre 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.

4. 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.

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.

MICROFINANCE AND POVERTY REDUCTION IN INDIA

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

Sustainable Micro Finance-features and Principles:

Microfinance is considered to be an adequate tool for financing small scale activities/technological applications in the rural areas because of the following features.

(a) Provide credit for investment in small scale activities chosen by the poor people.

(b) Empower the poor to build self confidence that I can do something.

(c) Can pay for itself with the interest earned.

(d) Allow to develop opportunities for self employment to the underserved people.

(e) Have the broadest utility and the least cost per beneficiary.

The principles of sustainable micro-financing are as follows:

(i) It offers flexible customer friendly services preferred by low-income group,

(ii) It has opportunities for streamlining operations and reducing costs (standardized simple lending process, decentralized loan approval, inexpensive offices, and use staff from local communities)

(iii) It operates in market basis charging market interest rates and fees, and

(iv) It strives to recover the costs of the loan.

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, do 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 moneylenders 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. 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.

Salient 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.

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 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 developing 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.

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