



MICRO FINANCE AS A TOOL FOR ERADICATION OF POVERTY

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ABSTRACT

India has travelled a long distance on the road to development since independence and has made significance progress in various sectors. The development in rural areas, however, has not kept pace with the overall progress in other facets of national life. Even today, nearly one third of the rural poor subsist in poverty and there remains an acute shortage of basic facilities like housing, drinking water, road in rural areas. To correct the imbalance, remedial steps have been taken in the last few years to bring rural development in the forefront of national reconstruction. In this case, the concept of Micro Finance was introduced for overcoming the existing constraints and providing adequate credit to the poor in the rural areas. Micro Finance is the provision that provides access to various financial services such as credit, saving, micro-insurance, remittances, leasing to low-income clients. Micro Finance becomes a buzzword in the credit markets as an effective tool for poverty reduction and socio-economic development. It is a broad category of services, which include micro credit. Micro credit is one of the aspect of micro finance and the two are often confused the micro finance revolution in India as a powerful tool for poverty alleviation. In this paper, an attempt has been taken to study the impact of micro finance on the low income people. Based on the findings we consider micro finance as an effective tool for breaking the vicious circle of poverty. Moreover, it also studies the schemes of govt. of India and the salient features of micro finance programme of govt. of India.

KEY WORDS: *Development, poverty, microfinance, microcredit, vicious circle of poverty.*

1. INTRODUCTION

The topic of micro finance has been receiving increased attention and has become a centre of discussion among experts in recent decades. Micro Finance is often presented as a panacea for poverty alleviation, particularly in developing countries.

According to Robinson (2001), poverty in developing countries is associated with low economic development, high population growth, unequal distribution of resources, wide-spread diseases, etc. This results in low productivity as well as unemployment of the poor.

According to Bassem (2012), micro finance is a response to the debt problems and economic crisis in most developing countries. In the sense, it is seen as one of the tools intended to reduce poverty.

Micro finance can help low income individuals start running their own business and build assets, reduce risk, raise productivity, obtain higher returns on investments, increase their incomes and, above all, improve the quality of their lives. The fact that financial services are available to anybody can be

considered the biggest benefit of microfinance institutions (MFIs) to the poor. Providing small loans, so-called microcredit, is generally considered as the basis of microfinance services. Micro finance providers also offer social and technical services. Examples includes group formation, the development of self-confidence, training in financial literacy and management, and other non-financial services related to enterprise development, such as skill training and marketing as well as social services, such as literacy training, health care, etc. Thus the definition of microfinance should include both financial intermediation and social intermediation. Generally, microfinance is not simply banking; it is a development tool.

2. OBJECTIVES

The main objectives of this paper are-

- To analyse the role of micro-finance institutions.
- To study the micro-finance and poverty reduction in India.



- To study few schemes taken by the Govt. of India.

3. METHODOLOGY

This paper is basically descriptive and analytical in nature. In this paper, an attempt has been taken to analyse the role of micro finance in reducing poverty in India. Data and information for the study are collected and analysed from secondary sources like newspaper, books, web sites, etc.

4. FINDINGS AND DISCUSSIONS

4.1 Micro Finance

Microfinance is termed as the financial services rendered to the deprived groups of the people and small entrepreneurs in savings, credit, remittance, micro-insurance etc. to help them in developing self-employment opportunities and various income generating activities.

4.2 History of Micro Finance

In the late 1970's, returning from U.S. where Yunus obtained his Ph.D in economics, Yunus started an organisation called Grameen Bank. Back in his hometown in Bangladesh, Yunus saw the extreme poverty in the country. Yunus was angry with the formal institutions (e.g. the World Bank, commercial banks) who had failed to help his fellow citizens. Yunus believed that formal institutions "pronounced a death sentence on the poor" because they "rejected the poor as unworthy of credit", imposing a "financial apartheid". Yunus decides he would help the poor by stepping outside of the formal institutions and providing small loans without collateral to groups of 5 borrowers; this became known as the Classical Grameen model. One village bank 1 (of several groups of borrowers) grew to two, and two grew to three, until Grameen Bank became one of the largest microfinance organisations in the world. Yunus classical Grameen model came to be known as "Micro Finance".

4.3 Role of Micro finance institution

a. 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 microenterprise. 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.

b. 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 source 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 NGOs to uplift them both economically and socially. It has been an accepted promise 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 programmes. 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.

c. 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 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.

d. 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 initiatives, 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 increase the self-esteem of the poor by giving the opportunities to be employed.

e. SHG-bank linkage programme

Indian microfinance 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 saving that is 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; 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 unreached 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.

4.4 Micro Finance 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 transfer”. 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, 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 they 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 follow:

- 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 serves to recover the costs of the loan.



Role of Micro-Finance 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 straightforward, 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 loans. Formal financial institutions have little incentives to lend to the rural poor for the following reasons.

Administrative 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 systematic 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 contract 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 amounts 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 features of many rural communities are that much of the local information does not flow freely; it tends to be segmented and circulates only within specific groups.

4.5 Few Schemes of Govt. of India

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 MIFs/NGOs. Under the programme, total amount of Rs. 191 crore have been sanctioned upto 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 this 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.

Salient Features of Micro-Finance Programme of Government of India

- a. Arranging Fixed Deposits for MFIs/NGOs:
Under this scheme, Government of India arranges 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 Govt. of India would help in institution building through identification and development of 'intermediary organisation', which would help the NGOs/SHGs in identification of products, preparation of project report, working out forward and backward linkage 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.

5. CONCLUSION

Microcredit and Microfinance have received extensive recognition as a strategy for poverty reduction and for economic empowerment. From the above study we can say that 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 household's 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.

6. REFERENCES

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