IMPACT OF MICRO FINANCE SECTOR ON POVERTY ALLEVIATION IN INDIA

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ABSTRACT

Microfinance can play a vital role to raise the living standard of people at a faster rate. In most cases, microfinance and MFIs are supported by grant funding. In order to achieve scale and viable business operations, we need capital infusion and funds / loans available in a larger and more organized manner. The purpose of this paper is to examine the role of micro finance in the empowerment of people & deals with the theme of microfinance and poverty reduction. 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.

Keywords:-

Poverty Reduction, Microfinance, Rural Finance, capital infusion, Rural Development

INTRODUCTION

Microfinance 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. Microfinance includes micro credit. Micro credit is provision of credit services to poor clients. It is the provision of financial services to micro-entrepreneurs and small businesses, which lack access to banking and related services due to the high transaction costs associated with serving these client categories. According to the records of World Bank, India falls under low income class. It is second populated country in the world. 70 percent of its population lives in rural area. 60% of people depend on agriculture; as a result, rate of underemployment is high. According to Reserve Bank of India, about 51 % of people house possess only 10% of the total asset of India .This has resulted low production capacity both in agriculture (which contribute around 22-25% of GDP) and Manufacturing sector. Rural people have very low access to institutionalized credit (from commercial bank). Since the 1990s, poverty reduction has taken priority at both national and international development levels. Within this framework, various initiatives have been taken. Microfinance has caught the attention of many aid donors, NGOs and Governments as an effective tool for poverty reduction. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which however is closer to the retail finance model prevalent in mainstream banking. The root cause of the problem of poverty has been found to be the economic dependence and lack of access to the credit. Poor have been considered to be non bankable. They are depriving of the basic financial services specifically the banking financial services. Micro finance is one such intervention that aims at poverty reduction by providing basic financial services to the underserved section of the society at affordable cost. Microfinance can play a vital role to raise the living standard of people at a faster rate. In most cases, microfinance and MFIs are supported by grant funding. In order to achieve scale and viable business operations, we need capital infusion and funds / loans available in a larger and more organized manner. The purpose of this paper is to examine the role of micro finance in the empowerment of people & deals with the theme of microfinance and poverty reduction.

Historical Background and Present Status of Micro-Finance in India

While technology and finance hold the key to ameliorate poverty, the poor in India do not have adequate access to the formal banking sector. Inaccessibility of the poor to the formal/institutional banking sector is mainly due to the following reasons:

(a) Lack of good retail outlets offering banking services, (b) lack of assets with the poor that could be used as collaterals and (c) illiteracy of the poor. The credit requirement of the poor in India has been estimated by the World Bank to be around Rs.50,000 crore per annum in 2002. Against this requirement, the credit outstanding of the poor with the formal banking sector is stated to be Rs.5000 crore or ten per cent of the total demand. The poor require finance for both production and consumption purposes. Production loan may be of three types, viz. (a) short term (for periods up to 15 months), (b) medium term (from 15 months to 5 years) and (c) long term (for periods above five years). Economic activity in rural areas may relate to the various sectors of crop husbandry, animal husbandry, poultry, fishery, cottage & village industries, handicrafts, transportation, repair shops, and trade & services. But the recent strategy is to ensure flexibility in lending and in repayment based on the capacity of the borrower to earn enough to repay- whether it is daily, weekly, monthly or seasonal. Short term loans may be required by the poor for purchasing (HYV) seeds, fertilizer and for irrigating a leased-in land etc. Medium term loans may be required for purchase of bullocks (or a boat) and for purchase of machinery and equipment. Long term loans may be required for repayment of loans, for constructing a shed/shop and for purchase of land etc. What needs to be appreciated is that all the three kinds of production loans are relevant to the poor.

About two-thirds of the estimated credit requirement of the poor is said to be on account of consumption needs. Nearly three-quarters of this consumption need (Rs.25, 000 crore) is stated to meet emergencies like illness and household expenses during the lean seasons. It is worth mentioning that due to lack of employment, and incomes during the lean seasons, the poor are often not in a position to buy subsidized food grains from the Targeted Public Distribution System (TPDS). If consumption loan could be made available through the formal banking sector, the poor will benefit not only by way of lower interest rate but also in terms of realizing the subsidy on food grains/items of TPDS. Alternatively, food grains credit could be provided

directly under TPDS. It is important to note that consumption loans are also as relevant to the poor as production loans. Availability of finance, moreover, tilts the employment scenario in favour of self-employment vis-à-vis wage employment. An added dimension is the empowerment of women with easier availability of micro-finance to them. Going by the estimates provided earlier, the demand for production credit in the country today is equal to Rs.17000 crore per annum whereas the total credit outstanding under micro-finance is merely Rs.5000 crore. Thus, there is definitely a need to increase the flow of credit, both for consumption and production, to the rural sector.

REVIEW OF LITERATURE

Seibel and parhusip (1990) mention that this approach was based on the premise that rural micro –entrepreneurs are unable to organize themselves, they need subsidized credit for increasing their income and are too poor to save. Yaron, Benjamin & Piprek (1997) have traced this traditional approach in rural finance leaning heavily towards direct intervention to Keynesian influence .Under this approach ,in addition to the assumption listed above, the key problem areas visualized in rural finance markets included a lack of credit in rural areas, absence of modern technology in agriculture, low saving capacity in rural areas under prevalence of usurious money lenders these distortion and imperfection in rural credit markets were sought to be addressed through government intervention .with difference of range and degree, most developing countries from 1950s to the 1980s were home intervention ranging from establishing state owned financial institutions, interest rate ceiling on deposits and credit, credit subsidy, direction credit to particular sectors and nationalization of private banks.

Research Methodology

This is a descriptive research paper based on secondary data. Data have been found out through different websites, research papers and magazines.

Evolution of Micro finance

Microfinance as an industry evolved in all the third world countries almost at the same time span. World over, it was getting widely recognized that improving income levels of low-income community is essential to improve their well-being – besides the state sponsored welfare programmers. During the 1970s and 1980s, the micro enterprise movement led to the emergence of Non-Governmental Organizations (NGOs) that provided small loans for the

poor. In 1990s, across the world, a number of these institutions transformed themselves into formal financial institutions in order to access and on-lend funds, thus enhancing their outreach. One of the significant events that helped it gained prominence in the 1970s was through the efforts of Mohammad Yunus, a microfinance pioneer and founder of the Grameena Bank of Bangladesh. In 2006, Prof. Yunus was awarded Nobel Peace prize "for his efforts to create economic and social development from below." In India, many formal financial institutional structures were experimented with – Regional Rural Banks (RRBs), District Central Credit Cooperative Banks (DCCBs), Local Area Banks (LABs), Self-Help Group (SHG) Bank linkage program. All these received mixed success and paralelly; the civil society organizations started feeling the need to offer financial services to the poor. Credit was getting increasingly recognized as an essential tool to break the vicious cycle of poverty. Gradually, Microfinance Institutions emerged in 1990s and 2000s. MFIs today differ in size and reach; some serve a few thousand clients in their immediate geographical area, while others serve hundreds of thousands, even millions, in a large geographical region, through numerous branches.

Why Microfinance

1. No Provision of Financial Services by Bankers- Traditionally, banks have not provided financial services, such as loans, to clients with little or no cash income.

2. Substantial Cost of Loan- Banks incur substantial costs to manage a client account, regardless of how small the sums of money involved.

3. Lack of Collateral Security in Poor People- most poor people have few assets that can be secured by a bank as collateral.

4. Lack of Financial Services in Developing Countries- However, the efforts of national planners and experts to develop financial services for most people have often failed in developing countries,

5. High Rate of Interest- Because of these difficulties, when poor people borrow them often relies on relatives or a local moneylender, whose interest rates can be very high. An analysis of 28 studies of informal money lending rates in 14 countries in Asia, Latin America and Africa concluded that 76% of moneylender rates exceed 10% per month, including 22% that exceeded 100% per month. Moneylenders usually charge higher rates to poorer borrowers than to less poor ones.

Microfinance Standards and Principles

1. Poor people need not just loans but also savings, insurance and money transfer services.
2. Microfinance must be useful to poor households: helping them raise income, build up assets and/or cushion themselves against external shocks.
3. "Microfinance can pay for itself." Subsidies from donors and government are scarce and uncertain, and so to reach large numbers of poor people, microfinance must pay for itself.
4. Microfinance means building permanent local institutions.
5. Microfinance also means integrating the financial needs of poor people into a country's mainstream financial system.
6. "The job of government is to enable financial services, not to provide them."
7. "Donor funds should complement private capital, not compete with it.
8. "The key bottleneck is the shortage of strong institutions and managers." Donors should focus on capacity building.
9. Interest rate ceilings hurt poor people by preventing microfinance institutions from covering their costs, which chokes off the supply of credit.
10. Microfinance institutions should measure and disclose their performance – both financially and socially.

Independent India: Searching for New Approaches to Reach the Rural Poor

Micro finance is expected to play a significant role in poverty alleviation and development. The need, therefore, is to share experiences and materials which will help not only in understanding successes and failures but also provide knowledge and Guidelines to strengthen and expand micro finance programmes.

About 238 million people in India live below poverty line with per capita income of less than 1 dollar per day. Only 95 % has no access to microfinance & 56 % people still borrow from informal sources, 87 % no access to credit from formal sources. 95 % of the households are without any kind of insurance, Informally Microfinance has been in practice for ages.

Since independence, policy makers and practitioners are trying to improve the lives of these people and fight against poverty. India faced an underdeveloped rural economy, high levels of indebtedness and a lack of efficient financial services. Since the 1950s the lack of rural development has been attributed to a lack of access to credit to finance production assets. Private Banks that should have provided such credit were absent from rural areas; and informal finance,

through moneylenders, friends relatives and rotating chit funds, was inadequate. 80% of the population lived in rural areas; 40%of GDP was contributed by agriculture; but only 2.2%of total credit went to agriculture –almost exclusively to medium and big farmers. Union Government took three related measures in 1969: the nationalization of 14 private banks (followed by another six in 1980); the requirement to open two rural branches for every urban branch; and a mandatory system of priority sector or lending. Hence the government introduced a network of government owned Regional Rural banks, regulated and supervised and banking institution with a low capital base of around Rs.250, 000, each covering with its branches a designated service area of 1-3 districts.

Table1.1

Rural Share of Banks		
Bank Group	**Rural Branches**	**Total Branches**
Public Sector Banks	**20398**	**64673**
Old Private Sector Banks	**765**	**5028**
New Private Sector Banks	**547**	**6973**
Foreign Banks	**7**	**319**
Regional Rural Banks	**11871**	**16034**
Local Area Banks	**14**	**53**
All Commercial Banks	**33602**	**93080**

Source:- Stastical table relating to banks in India 2011-12 by RB

Table1.1

It indicates that on 31st March public sector banks have 64,673 branches out of which 31.54 percent share is of rural branches. Private sector banks have only 10.93 percent share in rural areas. If we see the condition of foreign banks it has very negligible share in rural areas (7 out of 326).Whereas regional rural banks have about 75.00 percent share in rural branches. Local area banks and commercial banks have 26.41 percent and 36.10 percent share in rural areas respectively. It indicates that regional rural banks play important role in rural finance.

Success Factors of Micro-Finance in Rural India

Over the last ten years, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial

services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grass root savings and credit groups around the world have shown that these micro enterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

Microfinance Debates and Challenges

There are several key debates at the boundaries of microfinance-

Interest Rates- One of the principal challenges of microfinance is providing small loans at an affordable cost. The global average interest and fee rate is estimated at 37%, with rates reaching as high as 70% in some markets. The reason for the high interest rates is not primarily cost of capital. Indeed, the local microfinance organizations that receive zero-interest loan capital from the online micro lending platform Kiva charge average interest and fee rates of 35.21%. Rather, the main reason for the high cost of microfinance loans is the high transaction cost of traditional microfinance operations relative to loan size. The high costs of traditional microfinance loans limit their effectiveness as a poverty-fighting tool.

Use of Loans- Practitioners and donors from the charitable side of microfinance frequently argue for restricting micro credit to loans for productive purposes–such as to start or expand a micro enterprise. Those from the private-sector side respond that because money is fungible, such a restriction is impossible to enforce, and that in any case it should not be up to rich people to determine how poor people use their money.

Social Performance Management Principle of Micro Finance Institutions

Micro Finance Institutions are at a stage where they have to prove to themselves that they create value to their clients through appropriate financial services and are responsible financiers. While Micro Finance Institutions have been able to adopt a code of conduct and client protection principles, they are yet to integrate Social Performance Management principles fully. The movement from code of conduct to responsible finance and further to Social Performance Management has been linear in many institutions. Micro Finance Institutions most important assets are not their loan portfolios, but their relationships with their clients. Social Performance Management thus has brought clients back into focus and reiterates that Micro Finance Institutions exist to serve the clients. Unless the customers are chosen with care, well-served and

the relationship sustained over a long time, the Micro Finance Institutions, whether commercial or developmental, cannot hope to survive. Growth over a long period of time and sustainability of institutions will critically depend not just on the numbers of clients and volume of business, but the quality of service and relevance of the services to the customer community. To ensure that Micro Finance Institutions remain relevant to their local context and are seen as important institutions, Social Performance Management in these institutions is a necessity. Weak SPM practices aggravate political risks and result in erosion of customer loyalty. However, responsible finance and Social Performance Management are to be followed not only by these institutions but other key stakeholders in the industry. Lenders to Micro Finance Institutions, investors, governments and regulators need to work in coordination to achieve the desired goal of responsible finance. Micro Finance Institutions are just the delivery edge of microfinance. Investors, funders, regulators and opinion makers are those who have a responsibility to ensure that the edge remains sharp and functional. It providing a facilitative policy environment, designing suitable mechanisms from which Micro Finance Institutions can access equity and funding resources, reducing political and policy risks, avoidance of distortion of microfinance markets and a sound regulatory framework are the responsibilities of other stakeholders.

MICROFINANCE AND NATIONAL OBJECTIVES

- **National Poverty Reduction Strategy**

Microfinance is seen as an important instrument in the implementation of the Government programme to reduce the number of the people below the poverty line from 60% in 2000 to 30% in 2015.The new Economic Development and Poverty Reduction Strategy (EDPRS) emphasizes the role of microfinance in the fight to reduce poverty and to increase economic growth in Rwanda. In its Vision 2020, the government also points out to the role that microfinance sector will play in the attainment of the goals of the government's Vision 2020 programme. This vision is focused to transforming Rwanda from a low income to a medium country with dynamic, diversified, integrated and competitive economy (Republic of Rwanda 2006)

- **Vision 2020 Umurenge**

Vision 2020 Umurenge is a rural development programme which aims to increase the efficiency of public service delivery and to reduce poverty, with the goal to eliminate extreme poverty by 2020. The programme reflects grass root priorities to be implemented at the village level using

community-based participatory approaches. The prime objective is to release the productive capacities of the poor and extremely poor. The programme, which is now being piloted, identifies certain vulnerable target groups and aims to deliver packaged interventions that meet the specific needs of a certain group. According to the vision, farmers owning small plots of land, for example, could be assisted with various initiatives aimed at increasing agricultural productivity. Similarly small scale entrepreneurs should be targeted by technical assistance schemes and micro-finance programmes. The often very poor agricultural wage labourers should be targeted by schemes to provide on- as well as off farm employment, training, and better access to financial services. And finally, landless individuals that are unable to work because of disability should be reached by social assistance (Bigsten, and Isaksson, 2008)

Rural consumption has been in an uptrend for last years- A trend we expect will continue… Figure 1.2

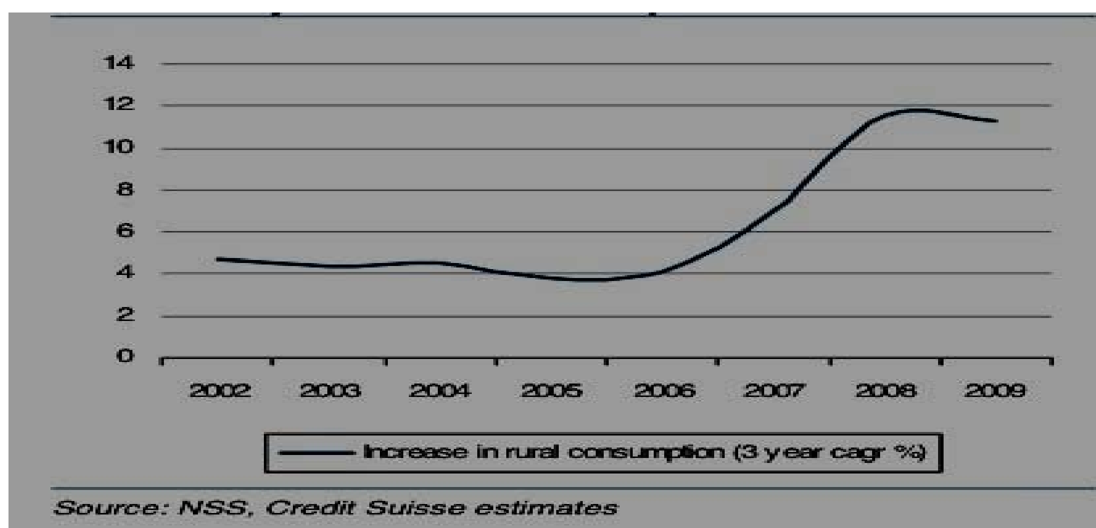

Figure 1.2 explains that rural consumption has been increased due to micro finance. In the year 2002 rural consumption was increased with more than 4 percent. Up to 2004 it remained constant and declined in 2005.From 2006 to 2009 there was about 11 percent increase in rural consumption. This increasing trend shows a positive response towards increase in rural consumption in future.

Findings

Considerable gap between demand and supply for all financial services & Majority of poor are excluded from financial services. This is due to the following reasons:

- Bankers feel that it is risky to finance poor peoples because of their credit worthiness.
- High transaction costs
- Poverty reduction and increase in employment due to microfinance.
- Increase in rural consumption due to microfinance.

CONCLUSION

There is ample evidence to support the positive impact of microfinance on poverty reduction as it relates to fully six out of seven of the Millennium Goals. In particular, there is overwhelming evidence substantiating a beneficial effect on income smoothing. Microfinance is an instrument that, under the right conditions, fits the needs of a broad range of the population—including the poorest—those in the bottom half of people living below the poverty line. While there will be people in this group who will not be suited for microfinance because of mental illness, etc., the exclusion of this small percentage of the population will likely not be a limiting operational issue for MFIs. Empirical indications are that the poorest can benefit from microfinance from both an economic and social well-being point-of-view, and that this can be done without jeopardizing the financial sustainability of the MFI. While there are many biases presented in the literature against extending microfinance to the poorest, there is little empirical evidence to support this position. However, if microfinance is to be used, specific targeting of the poorest will be necessary. Without this, MFIs are unlikely to create programs suitable for and focused on that group.

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