**International Journal of Research in Economics and Social Sciences (IJRESS)**
Available online at : http://euroasiapub.org
Vol. 6 Issue 11, November - 2016, pp~190~198
ISSN(o): 2249-7382 | Impact Factor: 6.225 , | Thomson Reuters ID: L-5236-2015

**Microfinance: A Poverty Alleviator or Debt Trap**

**BASAVANAGOWDA T**[1]

Research Scholar,
Department of Studies in Economics,
Davangere University, Shivagangotri.Davangere. Karnataka

## Introduction

The term "microfinance" describes the range of financial products (such as microloans, micro savings and micro-insurance products) that microfinance institution (MFIs) offer to their clients. Microfinance began in the 1970s when social entrepreneurs began lending money on a large scale to a working poor.

Historically, the goal of microfinance/microcredit was the alleviation of poverty. For many years, microfinance had this primary social objective and so traditional MFIs consisted only of non-governmental organization (NGO), specialized microfinance banks and public sector banks. More recently, market has been evolving. For example, some non-profit MFIs are transforming themselves into profit sinking institution to achieve greater strength, substantially and market reach. They are being joined in the microfinance market place by consumer finance companies, like GE finance and Citi Finance). "Big-Box" consumer retailers, like Wal-Mart, Elektra and Tesco are beginning to emerge as consumer lenders and a few are venturing into microfinance. Although most MFIs still consider poverty alleviation the primary goal, selling more products to more consumer is the primary motivation of many new entrants.

One individual who gained worldwide recognition for his work in microfinance is professor Muhammad Yunus who, with Grameen Bank, won the 2006 Nobel Peace Prize. Yunus and Grameen Bank demonstrated that the poor have the ability to pull themselves out of poverty. Yunus also demonstrated that loans made to the working poor, if properly structured, had very high repayment rates. It was when Muhammad Yunus won the Nobel Prize for Peace in 2006, that "Micro Credit" hit the headlines of the media. Poverty alleviation becomes the buzzword. A wave of euphoria for Micro Credit swept the public mind.

**Micro Credit resembled the magical Aladdin Lamp!** It seemed, the darkness of poverty would disappear as soon as the lamp was lit.

Now let's go back by a few decades. 'GaribiHatao' (Remove Poverty) was the popular political slogan raised on the eve of the 1971 parliamentary elections by Indira Gandhi, theformer leader of ruling congress party, to garner political support of the rural and urban poor constituting the largest potential vote-bank. The slogan dealt with an issue which should not be judged in isolation of the contemporary economic events. All over the worlds 'poverty alleviation' was the key issue of the developments theory since the 1970s till date.

**Birth of Microfinance**

Social system and sub-system of this culture are built on exploitation. The rich are exploiting the poor by putting them into a debt-trap of money-lending system. This system exists everywhere in the world wherever poverty exist. The poor people need money for their survival and as a result of it they become the part of the vicious circle of poverty where at one time they approach to the moneylenders and the other times to formal financial institutions.

Moreover, micro-finance is not limited to rural society or developing countries only; it is equally applicable to urban society and developed countries as well. In India, the need for micro-finance is higher as the deemed for credit to start micro-finance by the poor people could not be met by the institutional initiatives of rural finance up to large scale. Due to the failure of percolation theory of social development, poor are highly dependent on non-institutional sources of credit. Economic weaknesses of the Jajmani System also gave way to increased non-institutional sources of credit. Nut the irony is that MFIs ate making profits even from poverty. The poor are market base for the MFIs. They are charging heavy interest rates from this sector as against 9.5 % to 10.5% for Housing and Car loan in urban sector.

Availability of credit is the basic requirement of any citizen, more so to a poor person. Credit should be timely as well as easily available. Formal institutions, including nationalized banks are unable to meet the micro credit requirement of the poor people. This has left poor persons with no option except to depend on money lenders for credit. Money lenders with abundant common sense offer timely - but an exploitative credit, which act **as a poverty trap for the poor.** Various studies have proved that in rural India, a person taking credit from money lender for health or for a ritual like marriage forever has gone below the poverty line.

Poverty as we understand is a complex phenomena and it cannot be solved by providing income generation assets but through comprehensive personality development of poor person enabling him/her to various needs.

**Micro Financial Institutions: Making Profits From The Poverty**

Poverty has literally become a big and organized business. If you are educate a looking for a profitable business and more so if you are a non-resident Indians and want to Trans locate to India and still make millions, micro-finance offers you the right avenue. There can be no better business opportunities than starting micro finance institution with assured returns and 100% loan recovery. And still more importantly you can hold your head high and claim that you are helping the poor to come out of the poverty trap. The elite in the society have knowingly (or un-knowingly) given a license to loot.

The unprecedented growth in micro finance tells us that modern-day shylocks are everywhere, looking at every possible opportunity to make profits from poverty. Richcountries become rich at the cost of poor countries. Rich people in any society also (of course there are exceptions) follow the same path.

## MICROCREDIT: REALLY A DEBT TRAP

**With the expansion of microfinance, criticism is mounting that loan for poor people without financial education can become a debt trap. How real is the threat?**

According to India's National Crime Record Bureau, more than 97000 farmers committed suicide between 2003 and 2013, because of failing harvest and huge debts. In current year also in the month of July, 2015 major part of Gujarat and Rajasthan state suffered due to heavy rain and the crops have destroyed almost totally. The BPL population suffered a lot due to this. The serious interest rates of up to 36% to 40% and forced loan recovery practices are intimidating the poor. The human is earning for a day time only but the interest is accruing 24 hours round the clock. This and other incidents have led to mounting the criticism of micro credit as a debt trap for the poor.

## REASONABLY HIGH INTEREST RATES:

Many people who embrace microfinance are still shocked by the double-digit interest rates that MFIs charge their poor clients. Some MFIs were "Worse than money lenders" because they charged interest rates around 24 %. Further many poor people do not have the financial knowledge or experience to use debt to increase their wealth. Instead of using micro loans to invest in the business, many poor clients use them for a wedding, a festival, or to buy something. They think that once you have a credit card, you can buy anything. If you get micro loans it does not mean that you can buy things you could not afford before. And once you are defaulter for credit card payment, the rate of interest they charged is more than 30% and for cash advance more than 36 %. The main reason for loan default is illness and death of a family member. This can result in a debt trap. But micro-insurance could offer some potential protection here. The health and life insurance scheme of the present government at a very minor premium is very good step in this respect.

Another problem with microfinance that even proponents acknowledge is its rapid growth. More and more institutions are catering for the same regional markets, sometimes leading to fierce competition.

## MICROFINANCE: ONLY A ROMANTIC NOTION

Microcredit assumes that all poor people are entrepreneurs, if we mean somebody who creates value through innovation, drive, persistence, and good business skills, and then I think that most people are not entrepreneurs. Even in rich countries, I think that less than ten percent are self-employed; most people have a job with a regular salary. To assume that poor people are going to somehow become entrepreneurs is a romantic notion.

If the choice is between doing microcredit and doing nothing, I think we should still do microcredit, but that's the wrong way to frame the choice. The alternative is not to do anything; it is to do something different and better. The danger I see with microcredit is thatif we keep doing more of it, we will get an economy that is very inefficient and fragmented.

The biggest problem with microcredit is that people who get these small loans usually start or expand a very simple business. The most common business for microcredit is simple retail - selling groceries - where there are often too many people, fierce competition, and where they don't really earn enough money to get out of poverty. We need to create more jobs, and microcredit does not help to do that yet.

**DEBT SWAP FOR DEBT TRAP:**

Poverty has many dimensions and stems from several factors - economic, social and cultural. Although lack of opportunities for livelihood (economic) and denial of opportunities (social) are largely seen as a major casual factor for poverty, indebtedness in considered as important manifestation of household poverty in India. Related to this are issues of economic growth, socio-economic equity, access to and control over productive resources, gainful employment and income, and lack of implementation of labour standards. Indebtedness impacts differently on various classes of household and also has a bearing on intra household differences. Given that varied inter linkages between indebtedness and other socio-economic welfare dimensions; it has come to be seen as a crucial variable that must be addressed by policy makers. Despite a multitude of measures taken in this regard, chronic indebtedness and a structural inability to overcome bondage continues to plague poor households in rural India. Indebtedness has clearly become a way of life but over a certain threshold of debt repayment/ income, it prevents families to access basic amenities and has an important disempowering effect on them. It is accentuated in the Indian context by lack of access to affordable credit and has now been recognized as another significant contributory factor.

**The poor like the proverbial Indian farmer is born with debt, lives with and dies with debt.** It is not so much debt per se, but the price paid for the debt, which makes them poorer. The predatory lending practice of indigenous moneylenders charging usurious rate of interest have been perpetuating the legacy of poor's debt bondage.

The issue of usury has been before us for long. This continues to remain as a significant casual factor in compounding the problem of poverty. The present scenario continues to be one of grave concern, as the issue seems to be intractable. Thanks to microfinance intervention there are encouraging and positive signs of addressing this problem.

The poor on account of this high cost of debt face a life-long risk of helplessness with virtual mortgage of life itself. The approach to address the poverty, now, is increasingly focused on enhancing the access to credit.

**SOME HARD BUT TRUE FACTS**

In India nearly 70% of the population is without life and health insurance. The figure was even more than 80 % before the implementation of present central governments scheme of health and life insurance. Even after the "Jan-DhanYojna's" implementation almost 40% peoples are not having bank account. People can live without bank accounts but not mobile phones. Even the Hawkers, Maid servants and even beggars are using mobile phones thesedays to stay connected to others, "But they are not having bank accounts as they don't have a proof of address and can't fulfill the KYC (know your customer) norms, essential for opening a bank account. Only 70% of Microfinance given to a borrower reaches to the ultimate hands and almost 30% to 35% goes to brokers and other mediators. As such the cost of Microfinance itself is very high. Thanks to the present government's policy of opening bank account with zero balance and depositing such financial aids directly to the bank accounts, so that the above corruption can reduced to the large extent.

Another example that can be quoted is of credit card. A person spending beyond his capacity through credit card never comes out of debt and pays almost 42 % interest plus late payment and over limit charges plus service tax as a bonus.

## BITTER TRUTH OF MICROCREDIT

The problem with microcredit is that it simply doesn't do that much to lift the poor out of poverty. Countries that have lifted people out of poverty have not done it through microcredit. It's been through the development of larger enterprises which create jobs-for example, in place like china and Vietnam. The question is: 'could we not use the resources in a better way?' - For example, creating garment factories rather than creating individual entrepreneurs by giving them each a loan to buy a sewing machine.

Economists who have looked at how microcredit impacts national economic growth have not yet been impressed by micro credit. Micro credit does not increase the number of people with jobs or the gross domestic product of a country.

We can have a simple thought experiment to illustrate this criticism. In one scenario, a lender gives out 10000/- Rs. To each of 500 women so that each can buy a sewing machine and set up their own sewing micro enterprises. In the alternative scenario, a traditional financier lends Rs.50 Lacs to a single entrepreneur who sets up a garment manufacturing business that employs 500 people. In the first case, the women must make enough money to pay off their usually high-interest loans while competing with each other in exactly the same market niche. The garment manufacturer however can exploit economies of scale and use modern techniques.

"The biggest problem with microcredit is that people who get these small loans usually start or expand a very simple business. We need to create more jobs, and microcredit does not help to do that yet, what can we expect if we give a Rs. 10000/- loan for one year to a person? What magic can we expect from him? At the most, he can survive, and there can be small changes in his quality of life." Again the mentality, recently developed in the minds of people having small loans is that Government is going to declared Loan-waiver scheme before any election just like VDIS for black money. As such they are having well settled thought that they don't have to repay the money. The best example can be of JillaUdhyog Finance Scheme in which almost 90 % finance becomes NPAs and as on today rare nationalized banks are ready to accept such a proposal.

Banks now focus on making finance available as cheaply as possible rather than on poverty reduction: "the desired outcome is that people will come out of poverty - but unfortunatelyit is not the outcome on which microfinance focuses. Having a microfinance loan does not mean that you will get out of poverty; else it is quite possible that a poor may be removed from this world through suicide.

## CHALLENGES

The biggest challenges of microfinance sector are: (1) Lack of professional managerial expertise (2) Political interference - isolated cases of interference by local administrative bodies exist (3) General concern that the poor by definition must have a hard time making repayments.

Making Credit available to the poor should commendable. But as a tool of fighting global poverty, Micro Credit should be judged by its effectiveness, not by it good intentions. The causes of poverty are deeply rooted in the capitalist system of economy. Extending the credit net without removing the causes of poverty will not improve the condition of the poor. Impoverishment, deprivation, disease, illiteracy, gender discrimination and unemployment need much more than mere money flow through Micro credit. Poverty will remain there same as before to keep the programmed alive if the country's development plan relies on Micro Credit for removing poverty. Any significant change in prevailing financial condition of the poor calls for structural change, state initiative, political mobilization and initiation of a radically different development paradigm.

## REMEDIAL MEASURES

### Avoiding The Poverty Trap With Microinsurance

We believe that micro insurance can help people in poor communities to avoid falling in to the poverty trap. Clearly, poor people are mostly affected by natural disasters or critical illnesses. Micro-insurance can help them to cope with these shocks.

With 170,000 Employees worldwide, Allianz is very close to its customers. In some rural areas of emerging economies, our company has a particularly strong presence. Here, our micro-insurance policies have a positive social impact. At the same time they are building relationships to customers that will hopefully remember them in the future as they became wealthier.

One way of avoiding the debt trap is by selling micro-insurance on top of a micro-credit. Education and training is certainly a challenge. Taking out a microloan means receiving cash; taking out insurance is buying a promise. Creating awareness about the idea and value of insurance is therefore quite a challenge.

### Self Help is The Best Approach:

Experiments in various developing countries proved that poor can be helped by organizing them in to small self help groups. To touch the core of poverty, women are the best agents. Hence Women Self -Help Group (SHG) have became the ray of hope to the developmental practitioners.

A typical SHG constitutes 10-15 likeminded poor women living below poverty line.

Often the women belonging to neighborhood communities, sharing thoughts and problems with one other form into SHG. Members of SHGs save equal amounts as decided in their groups. The movement of SHGs started with a slogan 'save a rupee a day', of course there are number of groups today who are saving more than Rs.4/- or Rs.5/- a day.

### Starting of SHGs

Once the likeminded members come together, they open an account in either bank or post office in the home town of the group. The group authorizes any of the members (elected as group leaders) to operate the group account.

### Group Process:

Thrift is a good entry point and a binding force for poor women. They view their future in their savings, the savings which meet their immediate needs, and also provide security for their old age. Recently The PradhanMantri Pension Yojna for such SHGs proves the most efficient security their old age.

The meager savings of an individual may not be sufficient to meet her needs but all the savings of the group members put together can be of great help to one or two members of the group. In any best SHG, the credit operations also start at the end of first month itself where in the members put together their savings and sanction loan to a needy member. Every group will have its own set of rules and regulations like amount of savings by members, interest rate on savings, basis on which loans are to be prioritized, interest on loan and penal interest on defaulted amount.

**Groups Are Disciplined**

The basic pillar for success of SHGs in its discipline. Every group decides frequency group meeting, when and where to hold meeting. Best SHGs meet once in a week, but normally any SHG should meet at least once in a month. The frequency of meetings strengthens the group processes, higher the frequency, the better it is. A best group exerts their discipline through fining the absentee members and late coming members. The thrift as well as credit operations take place in the group meetings. The meetings have specific agenda and the discussions go on as per the agenda.

A poor women coming out of her house and attending meeting as a stake holder itself is a step towards empowerment.

In the meeting various issues are discussed at length and members decide who should be given the loan. The discussions take place in a democratic and transparent manner. In best SHGs, each meeting is presided by members in rotation and this help to impart leadership qualities to all the members.

Account are written in the meeting itself. The standard account include attendance register, saving and loan register, cash book, individual pass books. The accountants of are written either by members themselves or by a person employed by the SHG.

Best practices in SHG are being evolved continuously based on experiences, to illustrate a few, following are mentioned.

- Regular meetings.
- Continuous saving.
- Internal rotation of savings.
- Conduct of meetings with specific agenda.
- Thrift and credit operations taking place in the group meeting.
- Rotation of leaders.
- Transparent and democratic decision making.
- Non-exploitation of members needs.
- One for all and all for one.
- Urge for increase of corpus.
- Determination for economic and social development. CONCLUSION

Micro Credit may play a pivotal role in bringing about a favourable change in the financial position of the poor borrower. But the cases are few in number and cannot be generalized. For the majority of the borrowers the inflow of cash from sale proceeds falls short of the amount required to be paid for installment of loan repayment. They undertake distress sale of disposable assets, if any, owned by their family. Finally the borrowers are left with only one option: to borrow afresh to pay off the outstanding loan in full settlement. The borrowers-turned-entrepreneur becomes a borrower again. The borrower is put into the Micro Credit debt-trap.

Micro Credit has been intimately linked to 'poverty alleviation'. But does this convey the truth? Its impacts are far uplifting the poorest sections of the society. Micro Credit finds its way as another form of silently appropriating the surplus created by the labour power of the poor with invisible ropes of exploitation making them sink even lower in the social strata. Micro Credit is not a saviour of the poor. On the contrary, the state of impoverishment does not improve and sometimes it even worsens. Despite some limitations, such as those arising from potential unobservable important determinants of access of MFIs, significant positive effect on multidimensional welfare indicator has been confirmed. Now it is time for us to think: shall we be still hoodwinked by the praises and chants glorifying Micro Credit?

## References


- Osmani, Siddiqur R. (1989) “Limits to the alleviation of poverty through non-farm credit” Bangladesh
- Development Studies, 17,4: 1-18. Rahman, Aminur (1999). “Micro-credit Initiatives for Equitable and Sustainable Development: Who Pays?”
- World Development, 27 (1): 67-82. Johnson, Susan. (1999) “Gender and Microfinance: Guidelines for Good Practice”, manuscript, suzanjohnson®
- compuserve.com.
- Johnson, Susan; and Thalia Kidder. (1999) “Globalization and gender-dilemmas for microfinance organizations”,
- Small Enterprise Development, Vol. 10, No. 3, pp. 4- 15. Wolfensohn, James (2000). “Foreword”. In Vinod Thomas, M. Dailami, A. Dhareshwar, Daniel Kaufmann, N.Kishor, R. Lopez,
- Kabeer, Naila. (2001) “Conflicts Over Credit: Re-evaluating the Empowerment Potential of Loans to Womenin Rural Bangladesh”, World Development, Vol. 29, No. 1, pp. 63-84.
- Lall, Sanjaya (1982). Developing Countries as Exporters of Technology: The Indian Experience. Macmillan,London. Maddison, Angus (2001). Jomo K. S. [ed.] (2001). Southeast Asia's Industrialization: Industrial Policy, Capabilities and Sustainability.Palgrave, Houndmills.
- Kabeer, N. 2001. “Conflicts over Credit: Re-Evaluating the Empowerment Potential of Loans to Women inRural Bangladesh.” World Development 29(1): 63-84.
- Khandker, Shahidur R. (2005). “Microfinance and Poverty: Evidence Using Panel Data from Bangladesh”. WorldBank Economic Review, 19 (2): 263-286.
- Handbook on South Asian Economies. Edward Elgar, Cheltenham. Morduch, Jonathan (2000). Mahajan, Vijay (2005). “From Microcredit to Livelihood Finance”.

- Economic and Political Weekly, October 8. Dr S O Junare (2006). Microfinance as Business. Center for Micro Finance Development, Mumbai, MicroEconomic Review, 19 (2): 267-274.
- Tripathi, Salil (2006). "Microcredit Won't Make Poverty History". The Guardian, October 17.
- United Nations (2006). Building Inclusive Financial Sector for Development. United Nations, New York.
- Karnani, Aneel (2007). "Microfinance Misses its Mark". Stanford Social Innovation Review, Summer.
- Pollin, Robert (2007). "Microcredit: False Hopes and Real Possibilities". Foreign Policy Focus, http://www.fpif.org/fpiftxt/4323, accessed on Dec. 2, 2008. Ghate, P. 2007. Indian Microfinance: The Challenges of Rapid Growth. New Delhi: Sage Publications. Karlan, Dean, and Jonathan Zinman (2009). "Expanding Microenterprise Credit Access: Using Randomized
- Supply Decisions to Estimate the Impacts in Manila". Working Paper, July, Department of Economics,
- Yale University, New Haven.