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ROLE OF MICROFINANCE IN REDUCING THE DEPENDENCE ON INFORMAL BORROWING IN URBAN POOR OF KOLKATA

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Abstract

The poor, in the absence of a regular and stable source of income often seeks finances from local money lenders to cope with their financial urgencies. The informal moneylenders charge an exploitative amount of interest often using abusive collection techniques to take undue advantage of their vulnerability. Since for the poor, ongoing access to credit is more important to survival than the actual cost of the credit, they fall prey to the vicious cycle of the "Debt trap" which often translates into the death trap in an agrarian economy like India. Microfinance essentially addresses the credit needs of the poor by offering a reasonable and reliable credit delivery system. Since microfinance provides cheaper loans, access to microfinance is expected to reduce the incidence of informal borrowing. The role of microfinance in reducing informal borrowing though remains debated, is widely studied in rural economies but none of the studies so far have analysed this phenomenon in an urban setting. This study aims to evaluate the association of microfinance membership with incidence of informal borrowing in urban poor of Kolkata. The study is conducted on a total of 547 households which also comprises non member households as control group to study the effect of microfinance membership on informal borrowing in the last 3 years. It was found that urban poor households with membership in microfinance show significantly lesser informal borrowing as compared to the non member urban poor households.

Keywords: Microfinance, informal borrowing, Kolkata, urban poor, debt trap

Introduction

One of the early objectives of microfinance programmes since its inception in the 1970s has been the eradication of poverty by means of extending microcredit to the poor in villages. It was envisioned that the small loan would provide structural support to the livelihood of the poor and help the poor and women generate employment. Since the poor have low and irregular income which compounds to their inability to save, they lack sufficient retained funds to invest in tangible capital assets which would help them generate higher income. Provision of micro credit through the microfinance programme help the poor gain an easy and affordable access to funds which can be used for building physical and financial capital. What also emerged as a parallel impact of the microfinance was that it created an effective competition to the local moneylenders by providing cheaper loans. So availability of microcredit at relatively lower interest rates without any collateral helped the poor to drift away from the exploitative interest rate loans from local moneylenders and landlords. As the reach of microfinance deepens, it is expected that it will eventually lower the interest rates charged by the moneylenders and drive them out of business. As Muhammed Yunus, the founder of Grameen bank puts it right by saying that the central idea of microfinance programs has also been to free the poor from "clutches" of moneylenders. But evidence from the empirical literature on this subject remains debated and inconclusive. While there have been studies like Hoff and Stiglitz (1998) which have claimed a reduced informal borrowing after membership with microfinance, others have shown (Sinha and Matin 1998) that instances of informal borrowing in fact increases in members(customers of microfinance are popularly called as members) because they tend to borrow more from informal moneylenders to pay loans to the microfinance institutions which have a rigid repayment schedule. Khandker (2000) finds a heterogeneous effects of microfinance on informal borrowing; he finds that while the male members of microfinance borrow less from informal sources, it is not the same for the female members. Mallick (2012) and Berg et al. (2013) in their studies have focused on the changes in village level moneylender's interest due to penetration of microfinance in the village. They find that moneylender interest rates increase with higher microfinance program coverage. While results from studies conducted by Berg et al. (2013) suggest that households that borrowed from MFIs borrow less from informal sources following participation in microfinance. Since moneylenders have always been at the core of a poor rural agrarian economy it only becomes imperative to understand with empirical evidence the relationship between microfinance interventions and the incidence of informal borrowing. There is dearth of literature which gives systematic evidence on the effects of microfinance institutions (MFIs) on the informal borrowing of an individual or a household. Mallick (2012) in his study in 106 villages from Bangladesh reports a positive effect of MFI competition on moneylender interest rates, but the effects on households' demand for informal loans are not analyzed.

Literature Gap

The existing literature on the effects of Microfinance on informal borrowing is in the backdrop of rural agrarian economy, primarily because since its inception microfinance has focused on catering to the financial needs of the rural poor. Poverty is always associated with lack of economic growth of a place, so to reach the poor microfinance took the village route while ignoring the rural poor's urban counterpart. None of the studies have so far focused on the urban poor whose population is staggering to an enormous scale with increasing urbanization of cities. There are a lot of metrics which change from village setting to an urban setting. An agriculture based household primarily needs finances to reinvest in agriculture and the drivers of demand depend on the crop yields and life events. Whereas in an urban setting, the drivers of demand are educational loans for children, construction of a house, reinvestment in business, lifestyle needs along with life events. It becomes thus imperative to replicate the studies done in village setting in an urban setting. This study attempts to find the effect of microfinance programs on the incidence of informal borrowing in urban poor of Kolkata.

Materials and Methods

A multilevel random sampling is conducted to get the sample population. The city Kolkata is divided into eight geographic zones, out of which five densely populated zones are selected leaving out three zones with military cantonment areas and Maidaan (comprising of the Eden garden and greener patches). In each of the five zones two largest slum settlements are shortlisted. The next stage involves selection of samples from those slums colonies where Microfinance programmes are popular. The non members also belong to the same locality and the same socioeconomic class for a level comparison of the impact of microfinance. A sample population of 547 constituting both members and non members from Kolkata have been studied. The members are primarily from Microfinance Institutions (MFI) with a few representations from Self Help Group (SHG) and Self help Bank Linkage Programmes (SBLP). Members are at least in their third year of membership and informal borrowing history is being accounted for both the members and non members for the last three calendar years, the data is tabulated in Table 1. The study replicates the research methodology applied in a study conducted by Sangeetha Prathap (2011) in fisher households of Kerala.

Research Question

Does access to microfinance (Microfinance Institutions (MFI), Self help groups (SHG) and Self help group bank linkage model (SBLP))reduce the dependence on informal borrowing in urban poor households ?

Research Objective

To examine the dependence on informal borrowing in member and non member households.

Hypothesis

Access to microfinance reduces dependence on informal borrowing of a household.

Chi Square Test

Incidence of informal borrowings was measured as a categorical variable taking two values; '0' for no informal borrowings and '1' for incidence of informal borrowings. Hence chi square test, which can also be used as a non parametric test was used to make inference (Table 2).

Hypothesis Testing

H0: There is no difference in informal borrowings of member households and non member households

H1: Member households show lesser informal borrowings as compared to non member households.

Table 1. Membership category and Informal Finance

Membership Category	No Borrowing from informal sources	%share within category	Borrowed from Informal Sources	%share within category	Total
Non Members	70	37.4	117	62.6	187
SHG	11	39.3	17	60.7	28
SBLP	19	48.7	20	51.3	39
MFI	236	80.5	57	19.5	293
Total	336	61.4	211	38.5	547

(*Source : Survey)*

Table2. Chi square test of significance

	Value	df	Asymp Sig
Pearson Chi Square	20.532	3	0.000
Likelihood ratio	20.231	3	0.000
Linear by Linear association	19.432	1	0.000

Result of Chi square test X^2 **(3, N = 547) = 20.532, p < 0.01** was found to be significant at 1 per cent level of significance (Table 2). Hence the null hypothesis that there is no difference between informal borrowings of members and non-members households is rejected.

Alternative hypothesis which observes lesser informal borrowings for Microfinance members compared to non-members holds good.

Results and Discussions

In the study, It was observed that Incidence of informal borrowings reduced with membership in Microfinance with 62 percent of non members accessing informal borrowing while only 19 percent of MFI members accessing informal borrowing. The percentage of non members accessing informal finance was highest at 62 percent, followed by SHG 's 60 percent, followed by 51 percent of SBLP members and the lowest share among the MFI members at 19 percent. So It was hypothesized that informal borrowings reduced with membership in Microfinance. To test this hypothesis, chi square test was done. While membership with MFIs and SBLP show significantly low percentage of members borrowing informally as compared to the non-members, only a marginal reduction in informal borrowing was observed for the SHG members as compared to non-members. This can be attributed to the inflexibility of SHGs in responding to emergency needs. SHGs operate revolving credit which is extended to the members on the basis of turns. Repeat loan is not sanctioned unless the current loan is repaid. Emergency needs of finance cannot be serviced in such situations. This entails the households to borrow from the informal sources for coping with the emergency hopeful to service the debt once his/ her turn for loan in the SHG has arisen.

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