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EFFECT OF MICRO FINANCING IN POVERTY ALLEVIATION IN INDIAN ECONOMY

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Abstract

In India, the history of rural finance is typified by the image of a nationalized banking system, which has failed to deliver credit either sufficiently or on time. Microfinance, by contrast, is increasingly being seen as an innovation in lending and the panacea for rural India's indebtedness to moneylenders.[1]

Sometimes called 'banking for the poor", microfinance is an amazingly simple approach that has been proven to empower very poor people around the world to pull themselves out of poverty. Relying on their traditional skills and entrepreneurial instincts, very poor people, mostly women, use small loans (usually less than Rs. 10,000), other financial services, and support from local organizations called microfinance institutions (MFIs) to start, establish, sustain, or expand very small, self-supporting business. A key to microfinance is the recycling of loan amounts. As each loan is repaid – usually within six months to a year – the money is recycled as another loan, thus multiplying the value of each dollar in defeating global poverty, and changing lives and communities.[2]

Keywords : Micro Financing , Poverty , Indian Economy **,** Households, Labour, Sustainable Development

Introduction:-

In the microfinance process, poor households are given possibilities to improve their lives through their own labour. Access to microfinance is credited with reaching the poorest, increasing their income to have a sustainable impact in alleviating rural poverty and with providing a cost-effective, sustainable development model that is applicable not just in developing countries, but also among poorer communities in the developed world. The remarkable successes that pioneer MFIs have had in extending and recovering millions of loans to the poor has attracted worldwide attention.[3]

Growth of Micro Finance in India:-

There has been a skewed growth of SHGs across the regions. The southern region of India accounts for 67 per cent of SHGs and 78 per cent of SHG credit. The poorer regions like north-eastern, eastern and central regions account for only 0.2, 4.1 and 6.9 per cent of SHG credit (Dasgupta 2001). Hence there is a need for credit widening through SHGs among the rural poor. It calls for a more effective role by development agencies in promoting micro-credit.[4]

India's MFIs operate in 209 out of 331 poorest districts of the country; up by 5% over the previous years. The table below gives the volumes of MFIs, that is, excludes the volume of SHG-Bank linkage program.

The Microfinance Institutions (MFIs) in India

	MFIs with Loan Portfolio up to 5 crore	**MFIs with Loan Portfolio >5 to 50 crore**	**MFIs with Loan Portfolio over 50 crore**	**Total**	
Society	87.7	543.8	478.3	1,109.70	104
Trust	24	149.8	225.4	399.3	31
Cooperative Bank	8.3	-	-	8.3	8
MACS	5.2	11	-	16.2	10
Section 25 Company	11.6	127.4	543.6	682.6	22
NBFC	10.6	197.3	3,312.10	3,520.00	25
LAB or any other	13.6	13.7	134.7	162.0	16
Total	**161**	**1,043.00**	**4,694.10**	**5,898.20**	**-**
No of MFIs	**137**	**57**	**22**	**-**	**216**

Source: www.sa-dhan.net

Micro Finance and Poverty Eradication:-

Eventhough Micro Finance programme has been widely acclaimed for several reasons, there is little evidence to acclaim it as one that achieves sustainable eradication of poverty. Prof. Mahamud Yunus, the architect of Micro Finance programme had rightly described that *"Grameen credit is based on the premise that the poor have skills which remain unutilized or under-utilized. It is definitely not the lack of skills which make poor people poor. Grameen believes that the poverty is not created by the poor, it is created by the institutions and policies which surround them. In order no eliminate poverty all we need to do is to make appropriate changes in the institutions and policies, and/or create new ones"*. In the midst of globalised era where the institute on and policies are broadly deregularised in favour of creating positive atmosphere for cut throat competition, it is already evident that the small and infant industries and occupations are at a stake.

While talking about the role of micro credit in poverty reduction, two questions arise in mind. First, whether micro credit increases earning capacity of the poor families that is sufficient enough to move them out of the poverty trap. Second, whether the poverty alleviation is on sustainable basis or is it a temporary phenomenon. While majority of studies answer the first question, there is a need to explore the answer of the second question to assess the sustainability of micro credit impact on the poverty eradication.

Some critics have pointed out that while micro credit schemes can reduce vulnerability, they have not lifted women out of abject poverty or have taken a long time to demonstrate any significant impact. On their own, micro credit schemes have limitations as they cannot transform social relations and the structural causes of poverty.[5]

- The self-help groups were unable to disburse the kind of credit that could be used by members to generate sustainable long-run improvements in living standards. These groups had not received bank loans and relied largely upon lending to members from the groups' own corpus of savings. This was not unusual, given that, despite the existence of large numbers of self-help groups in Andhra Pradesh, bank loans to these groups formed a mere 0.6 per cent of total bank credit disbursed in the state in 2002. Individual group members received small loans of well below Rs. 5,000 at very high interest rates, of 2.5-3 per cent per month. The loans were also extremely short-term, with the women having to return both principal and interest within three to four months. The credit was used largely for consumption rather than investment in new income generating activities.[6]

- NGO-controlled micro credit does not offer a solution to the general problems of rural credit. It is not an instrument for mobilizing large-scale funds for technological change in the countryside, and it does not and cannot supplant the informal sector or overcome historical imperfections and fragmentation of rural credit markets. NGO-controlled micro credit projects in India cannot hope to achieve the spread and reach of the rural banking system. There are also problems of accountability involved here: NGO-controlled micro credit organizations are not accountable to public scrutiny or to local governments. Being essentially private, market-oriented organizations, their only formal responsibility is to their donors.

  Micro credit is neither a successful anti-poverty strategy nor is it an adequate response to the huge unmet credit needs of the rural population. This is not to deny that micro credit loans to rural working households can serve as a kind of palliative reform in the countryside. For all the weaknesses in its implementation, the Integrated Rural Development Porgramme played an important role in the 1980s in that it gave new access to millions of rural households to the formal banking system and increased levels of purchasing power in rural India.

  Small-scale credit schemes have also been the basis for useful and socially progressive experiments in social mobilization. The large-scale participation of women in SHGs has been viewed as a means of women's empowerment. This is an area for further research but case study evidence warns against relying solely on micro credit to alleviate poverty and empower women. For example, in a detailed study of SHGs in two villages of the Telangana region of Andhra Pradesh, Smriti Rao found that the groups excluded the poorest and perpetuated existing caste and class hierarchies (Rao 2005).[7]

- The major argument against micro-credit is its failure to reach the poorest of the poor. The exclusion of the poorest is well known. Indeed, there is often a presumption that the moderately poor are less likely to default than those who are acutely poor. Some important factors resulting in this exclusion are lack of awareness, social exclusion of the poor and collusion of officials of micro-credit institutions with non-poor households. Too much of financial discipline/stringency, that is, strict repayment requirements and penalties for delays, could deter the poor form joining a micro-credit scheme or could limit their duration of participation in it (Madheswaran and Dharmadhikary 2001).

- It is true that the borrower of Micro Credit does not have to show any collateral, but she/he has to be accountable to the groups she/he belongs. This belonging to the group works as collateral. The borrower receives the amount minus some savings, (about 10%) and has to repay the loan in weekly installments with interest of around 20 to 40% of the total in average. Since more than 20% returns on the loan amount is essential to maintain repayment regularly for every week, every month and every year without a break, if anything happens to break the payment or if the borrower cannot earn more or at least equal to the repayment amount, s/he becomes a defaulter, which has a chain effect. It is assumed that, cateris paribus, as standard practice in economics, other things remain the same, meaning everything would be favourable for weeks, months and years. No natural disaster, no accident, no sickness. But the reality does not favour these assumptions. The further hidden assumption is that the property relations, power structure, and market processes all favour the poor, which has been proved completely wrong. For every breakdown of the model with wrong assumptions the borrower faces helpless uncertainty. Defaulters, therefore, are on the rise among the poor who are compelled to take new loans from other sources at higher interest rates.[8]

Micro Finance and Recovery Problem:-

- It is observed that as the size and frequency of loans increase, the repayment slackens. Again, high repayment rates invariably result in high transaction costs. A study of the financial performance of SEWA bank, which advances around Rs. 100 million annually, revealed that "overdues are the major area of concern" – NPAs being as high as 28%, 20%, and 27% during the financial years 1996-97 to 1998-99 (Ghosh, 2001). Another weakness of NGOs that surfaced as their activities increased is that the NGO-controlled micro credit projects could not spread out across the geography of the country resulting in many people living below poverty line not being serviced. They being private bodies believed that they are responsible only to their donors, and in the process they exhibited a poor sense of accountability to the public. In all, as Madhura Swaminathan (2007) observed, NGO-controlled micro credit organizations cannot be relied upon to eradicate poverty from the rural India, and hence the banking system must resume the role of credit supplier to the rural folk. This is all the more urgent in the light of the reports that even today, more than 56% of rural people's credit needs are met by traditional money-lenders (Anil K. Khandelwal, 2007).

High Interest Rates:-

The issue of high interest rates charged on micro credit beneficiaries also claims lot of concern, certain observations are provided hereunder:

- Despite an emphasis on a low interest rate regime in the economy in recent years, the rate of interest on loans advanced by micro-credit programmes is high: the modal rate of interest appears to be between 24 per cent and 36 per cent per annum. Rate of interest of 60 per cent per annum have also been reported. In other words, the rates of interest on loans given by micro-credit agencies are much higher than the rates charged by lenders in the formal sector.

- The rates of interest charged by micro-credit organizations represent a sharp increase compared to the pre-1991 period of credit disbursal to the poor, such as under schemes like the Integrated Rural Development Programme (IRDP).

  High rate of interest on loans are effectively a burden on the incomes of the poor. The professed objective of micro-credit, of providing means to free the poor from poverty, is thus defeated; the cost of such credit precludes any such freedom.[9]

- It must clearly be understood that poverty eradication in India's backward regions is impossible without a critical minimum dose of public investments – in natural resource regeneration, sustainable agriculture and a whole range of nature-based livelihoods as also infrastructure – that create the enabling environment for private investments to flourish. One of the worst directions the SBL programme has taken is its obsession with the setting up of micro enterprises, which has often been attempted as mindlessly as the IRDP was. By itself microfinance can achieve little even in this direction. Many allied inputs are required – forward and backward linkages (input-market support), appropriate skills and technologies as well as finance for fixed assets and working capital (Dichter 2004; Mahajan 2005). Without working out this entire package, microcredit can easily become "macrodebt", pushing the poor into traps they find very hard to escape. It is truly ironic that the very same people who sing paeans of globalization are promoting micro enterprises as the answer to world poverty without waiting to reflect on how they expect these micro enterprises to withstand the unbearable pressures of global competition.[10]

Conclusion

A few suggestions hereunder can be considered for alleviation of poverty:

- Microfinance is not a panacea for eradicating poverty but it is only one of the effective tools to help the poor develop themselves. For instance, poor people suffering from malnourishment, or illness, or lack of skills cannot be a target of microfinance institutes' lending program. The reason being: mere intervention in the form of capital injection cannot increase an individual's income for he cannot undertake the work. In other words microfinance makes sense only when people are capable of working. That is where the government has to step in with an appropriate mix of welfare measures and make people capable of undertaking jobs. In this context, the fear of fiscal profligacy should not deter the government. If need be, the government should invite participation from the corporate world by formulating suitable welfare schemes for honing the skills and capabilities of poverty – stricken people to engage themselves in self-employment.

❖ While there are no magical strategies to reduce poverty, a set of measures, each measure with its own dosage and timing without distracting the greater emphasis on provision of microfinance services for the rural poor, may be undertaken. Such a set would include several of the following in one form or another, with greater or lesser intensity, and to be applied either immediately or in the future: encouraging the participation of the poor in planning and implementation of poverty alleviation projects; provision of access to productive assets and public infrastructure to the poor; elimination of the bias against females in the access to resources through policy inducement; removal of policy bias against rural development; and finally, instituting a set of fair and effective laws and regulations governing resource use.

❖ Government involvement in SHG-based microfinance is a welcome development but it is not free from its ills. Government aid almost always brings in its wake political favoritism and corruption. It is important to ensure that the government microfinance initiatives do not go the way of their several well-intentioned predecessors. Micro credit cannot be expected to be a panacea to rural developmental problems.

❖ Micro-Finance has shown that, the risk can be minimized with through mechanisms like door-step banking, group collaterals, flexible and innovative products, repayments in small amount and greater frequency. Micro-Finance has demonstrated the possibility of reduced risks, cost recovery, and even profitability. It has demonstrated the possibility of reduced risks, cost effective, and even profitability. It has had relative success with small loans of short maturity if success is to be measured by high repayment rates. It has met certainly the needs of significantly larger sums for the non-farm sector. The essence for success of micro-finance lies in its voluntary character. It should not be over regulated at the disbursing end. Despite achieving significant progress of micro-finance coercive collection practices is a major issued of concern, which causing for absconding or migrating out of the villages and even in some case allegedly, commits suicide. Inspite of prompt repayment of loan by the groups some bankers are reluctant to extended further financing assistance.

- There is not a Grameen Bank (GB) blueprint that can be handed out universally and replicated. An approach or method cannot be replicated in a fixed, prescriptionary way. Replication demands a lot of experimentation and adaptation. With proper modifications, where necessary, the GB approach has a fair chance of success in densely settled poverty-stricken areas in rural Asia. In Africa and Latin America, however, an appropriate delivery mechanism specific to each case has to be worked out through trial and error.

- Yunus's long-term vision is to eliminate poverty in the world. The vision cannot be realized by means of micro credit alone. Despite its limited impact on poverty alleviation, the Grameen movement has demonstrated the importance of thinking creatively about institutional innovations, and is forcing economists and other social scientists to rethink the traditional wisdom about the nature of poverty and its alleviation. In the end, this may prove to be the most important legacy of the movement.

- Efforts to reduce the costs of participation that must be borne by poor women, and to ensure that the credit disbursed through the groups is cheap enough and large enough in volume to substitute for the informal sector, would certainly require more and better trained staff and a financial commitment not just to loan-making but to administration of the programme over a long term. The state is happy to leave this work to NGOs, but NGOs are neither permanent bodies nor accountable in any way to the people. They cannot be a substitute for the state's own responsibility to its citizens.

- In a nutshell, micro-credit can play an effective role in achieving the long-cherished objectives of poverty alleviation and rural development by credit-deepening in rural India. The success stories of Bangladesh and Malawi, if repeated in Indian villages, may ensure multiple benefits for the rural economy. However, we should move forward with caution, making sure that the bad features of the formal credit delivery system do not creep into micro-credit.

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