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An Overview on Microfinance for Poverty Alleviation in India

[1]Prof. Santosh R Gore, [2]Mrs Jyoti V.Howale-Shinde

[1]NBN Sinhgad School of Management Studies Ph. No: 9423803232
E-Mail: goresir@gmail.com
[2]NBN Sinhgad School of Management Studies Ph. No: 8390160500
E-Mail:jvhowale28@gmail.com

ABSTRACT

Microfinance has evolved over the past quarter century across India into various operating forms and to a varying degree of success. The micro financial sector has great potential to assist in the national goal of financial inclusion and to add depth to India's financial and capital markets. Microfinance stands as one of the most promising and cost-effective tools in the fight against global poverty. Microfinance is being practiced as a tool to attack poverty the world over. Microfinance Institutions (MFIs) are those, which provide thrift, credit and other financial services and products of very small amounts mainly to the poor in rural, semi-urban or urban areas for enabling them to raise their income. It shows that access and efficient provision of microcredit can enable the poor to smooth their consumption, better manage their risks, gradually build their assets, develop their micro enterprises, enhance their income earning capacity, and enjoy an improved quality of life.

- Most of other finances other than micro and small finance are easy to be utilized for sect oral planning of an economy.
- Small rural population could not get the benefits of industrialization till their investment is participative to economy's growth.
- Poverty alleviation of rural India had been planned to be removed with 20 points programme which will be regulated by planning at the end of each five year plan.
- It was envisaged in 11th plan which is current five year plan that the fruits of industrial development in India should be perforated to rural population by the help of utilizing small saving for industrial capital formation.
- In Bangladesh the utilization if small and Microfinance was done by utilizing the infrastructure of Grameen bank and Nobel Prize in 2008 was awarded to Mohammed Yunus for his contribution in portfolio utilization through micro and small finance in Bangladesh.

This paper examines Indian microfinance and its role in poverty reduction. Microfinance has been found to be effective in lifting the poor in India above poverty level by providing them increased self-employment opportunities and making them credit worthy. Although poverty reduction has long been high priority for the Government of India, microfinance is still an experimental tool in its overall strategy.

INRODUCTION

Since Independence in 1947, the Government of India and the Reserve Bank of India (RBI) have made concerted efforts to provide the poor with access to credit. Despite the phenomenal increase in the physical outreach of formal credit institutions in the past several decades, the rural poor continue to depend on informal sources of credit. Institutions have also faced difficulties in dealing effectively with a large number of small borrowers, whose

credit needs are small and frequent and their ability to offer collaterals is limited. Besides, cumbersome procedures and risk perceptions of the banks left a gap in serving the credit needs of the rural poor.

This led to a search for alternative policies, systems and procedures, saving and loan products, other complementary services and new delivery mechanisms that would fulfill the requirements of the poor. It is in this context that micro credit has emerged as the most suitable and practical alternative to the conventional banking in reaching the hitherto unreached poor population.

Microfinance is the provision of a broad range of financial services such as deposits, loans, payments, money transfers, and insurance to the low-income households and their micro enterprises. The basic purpose of Microfinance is to provide access to financial assistance, including credit to the poor to enable them to start/expand micro enterprises to break out of poverty. Micro credit enables the poor people to be thrifty and helps them in availing the credit and other financial services for improving their income and living standards.

The micro credit programme, which was formally heralded in 1992 with a modest pilot project of linking Self-Help Groups (SHGs), has made rapid strides in India exhibiting considerable democratic functioning and group dynamisms. The micro credit programme in India is now the largest in the world. The SHG-Bank linkage Programme was launched in 1992 as a flagship programme by National Bank for Agriculture and Rural Development (NABARD). The programme envisages organisation of the rural poor into SHGs for building their capacities to manage their own finances and then negotiate bank credit on commercial terms.

Microfinance can be described as banking the unbankables, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks. “Microfinance is based on the premise that the poor have skills, which remain unutilized or underutilized. It is definitely not the lack of skills which make poor people poor. Charity is not the answer to poverty. It only helps poverty to continue. It creates dependency and takes the individual‘s initiative to break through the wall of poverty.

Microfinance is an important tool for social financial engineering in the battle against poverty. The most active states in India in the context of paradigm shift in microfinance are:

Kerala, Andhra Pradesh,Tamil Nadu, Karnataka, Himachal Pradesh and Uttaranchal.

MICROFINANCE IN INDIA OPERATES THROUGH TWO CHANNELS

- Microfinance institutions (MFIs)
- NABARD’s SHGs bank linkage programme (SBLP) - a partnership model between SHGs, banks and NGOs

ROLE OF MICROFINANCE 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 need 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 straight-forward, 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 over agricultural loans.

MICRO-FINANCE BASED POVERTY ALLEVIATION PROGRAMMES

As part of the poverty alleviation measures, the Government of India (GOI) launched the Swarnjayanti Gram Swarozgar Yojana (SGSY) in 1999 where the major emphasis is on self-help group (SHG) formation, social mobilisation and economic activation through micro-credit finance.

Up to March 2003, 13.38 lakh groups were constituted in 33 States and Union Territories, of which 33,436 SHGs only could take up economic activities for their economic sustenance.

Simultaneously, the Government supports the National Bank for Agriculture and Rural Development (Nabard) to take up activities such as group formation, micro-finance and economic activation.

Besides this, the Rashtriya Mahila Kosh (RMK, that is, National Credit Fund for Women) and the Department of Women and Child Development have their own programmes under which micro credit is being provided for economic empowerment of the rural poor.

The year 2001-02 marked a decade of self-help group-bank linkage programme in India. With the growing importance of the micro-credit through SHG-bank linkage in India, the Reserve Bank of India (RBI) in 1996 included financing to SHGs as a mainstream activity of banks under their priority sector lending.

It has been estimated that India has the world's largest micro-finance programme in terms of out-reach, with 7.8 million households accessing credit through 17,085 branches of the formal banking system under the micro-credit finance programme.

Impact of micro-finance

While the GOI tries to widen the micro-credit reach for the million poor in India through the self-employment scheme, namely, SGSY, the Nabard envisages reaching banking services to one-third of the very poor in India, that is, a population of about 100 million rural poor .

The potential

- Micro-finance is an innovative credit delivery mechanism that ensures viable financial services for the needy. It has the potential to address issues like actualising equitable gains from the development on a sustained basis and can play a vital role in developing nations in fighting poverty.
- The micro-finance scene in India is dominated by SHG-bank linkage programme. Though the groups existed even before the linkage programme (under the SGSY and Nabard's SHG-bank linkage programme), the banks could not recognise their potential as business clients and both operated independently in most of the cases, without knowing the strength of the other.
- Intervening to forge a linkage, besides SGSY, the Nabard has helped in the emergence of a very strong micro-finance movement in the country.
- The SHG-bank linkage programme was conceived with the objectives of supplementary credit delivery services for the un-reached 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 mobilisation functions contributing to an overall empowerment process.
- India has a strong potential to promote the women as key decision-makers through encouraged local leadership, which can be facilitated by complete involvement and participation of poor women in micro-credit programmes.
- This will succeed only with the coordination among the government, banks, participating members and microcredit finance institutions.
- Micro-finance can be a powerful tool in initiating a cyclical process of growth and development.
- Micro-finance activity can improve the access of rural poor to financial services.
- The micro-finance interventions help in inculcating necessary habits for economic independence and self-reliance. Appropriate and participatory credit plans by the members of a group can help in social and economic empowerment.
- Increased access signifies the overcoming of isolation of rural women in terms of their access to financial services and denial of credit due to absence of collateral security.
- The pool of savings generated out of very small but regular voluntary contributions improves access of the poor women to bank loans.
- It could also help in strengthening poor families' resistance to external shocks and reducing dependence on moneylenders.
- The group utilises its corpus to disburse loans of small amount amongst the needy members. In the beginning, the members meet out their consumption needs out of their own fund and afterwards they obtain loans from the Banks for taking up some economic activities for their sustained living.

The constraints

The mainstream financial institutions are generally seen as flushed with funds and have access to enormous amounts of low-cost savings deposits. It is found that the poorer the region, the lower the credit-deposit ratio.

Most of eastern Uttar Pradesh, Bihar, Orissa and the North-East regions have credit deposit ratios of 20-30 per cent. Some of the main reasons for the constraints associated with micro credit are:

- Non-productive loans and procedural delays for productive loans: Since most of the poor and needy are illiterate and prefer loans for consumption rather than productive purposes, majority of the poor find it hard to get loans sanctioned for taking up economic activities, even if they want to. Sometimes, the loanees are asked to furnish some documents and collateral security against the loan sanctioned, contrary to the directives of the Government and the RBI.
- Inflexibility and delay: The rigid systems and procedures for sanctioning loans and disbursing them to the beneficiaries result in a lot of delay in time for the borrowers, which de-motivate them.
- High transaction costs: Although the interest rate offered to the borrowers is regulated, the transaction costs in terms of the number of trips to be made, the documents to be furnished etc. plus the illegal charges demanded by the lending institutions clandestinely, result in increasing the cost of borrowing, thus, making it less attractive to the borrowers.

CURRENT POSITION OF MICROFINANCE IN INDIA

Microfinance seems to be failing to achieve its most noble goal: poverty alleviation. At worst, some lenders are contributing to a cycle of indebtedness and abuse, just like the loan sharks they sought to replace. Critics say the industry has grown too quickly for its own good, with too much rapaciousness and too little regulation. That has fostered a breakdown in lending discipline, with multiple loans to overextended borrowers, and allowed some unscrupulous players to thrive. Irresponsible lending leading to multiple loans without due diligence, unproductive loans for consumption and consumer durables, lack of transparency in operations, usurious interest rates, coercive recovery practices, have all resulted in hyper-profits to microfinance institutions and impoverishment of the poor.

Micro lenders, such as India's largest SKS Microfinance, give loans as low as $20 to small business and farmers but have been accused of charging excessively high rates and using aggressive tactics to recover money from borrowers. India's government plans legislation to crack down on microfinance institutions to stop them charging exorbitant interest rates, a finance ministry official says. Legislation, sparked by a string of suicides by impoverished borrowers, is expected to come before lawmakers this year. India's southern state of Andhra Pradesh, where SKS Microfinance and many other major microlenders are headquartered, passed legislation last year to cap lending rates and prevent strong-arm recovery practices. The most recent crisis to hit microfinance began in India's southern state of Andhra Pradesh, where allegations of widespread over-indebtedness, heavy-handed collection tactics and borrower suicides have stirred a national debate about regulating the industry. Andhra Pradesh, which accounts for $2.5 billion of microloans outstanding out of $7 billion nationwide, reined in microfinanciers after claims that high rates and arm-twisting debt collectors had caused 85 suicides.

In October 2010, the state government slapped restrictions on microfinance institutions that crippled lending and sent collection rates plummeting along with the share price of SKS Microfinance, India's largest for-profit microlender. On January 19,2011 the Malegam Committee Report, released by the Reserve Bank of India, recommended a range of new

regulations for India's microfinance institutions, including interest rate caps, loan limits and income ceilings for borrowers.

Recommendations of Malegam committee Report

Categorization of MFIs

- Creation of a separate category of NBFCs to be designated as NBFC-MFIs;
- NBFC-MFIs need to be companies providing financial services predominately to low income borrowers with not less than 90 per cent of total assets (other than cash and money market instruments) in the form of qualifying assets;

Terms of credit: borrowers, size and interest rate

- Borrower can be a member of only one SHG or Joint liability group;
- Limits on annual family income of borrowers recommended at ` 50,000;
- Individual ceiling on loan to single borrower recommended to be ` 25,000;
- Loans to be in small amounts with more frequent repayments than bank loans;
- The interest charged from borrowers subject to a 'margin cap' of 10 per cent for MFIs with loan portfolio of ` 100 crore and 12 per cent for smaller MFIs;
- Overall interest cap on loans at 24 per cent;
- Tenure of loan to vary with loan size;
- Restrictions recommended on the extent of 'other services' to be provided by MFIs;
- Not more than two MFIs can lend to a single borrower.

Resources, capital structure and provisioning

- Commercial Bank lending to NBFC-MFIs to qualify as 'priority lending';
- Minimum net worth of 15 crore for NBFC-MFIs.
- Capital Adequacy Ratio of 15%
- All of the Net Owned Funds should be in the form of Tier I Capital.
- MFIs encouraged to issue preference capital (with a ceiling on the coupon rate to be treated as part of Tier II capital
- Subject to capital adequacy norms

Consumer protection, code of governance and regulatory issues

- RBI to prepare a draft customer protection code;
- Grievance redressal mechanism to be established
- MFIs to observe code of corporate governance;
- Responsibility of avoiding coercive recovery methods to rest on MFIs;
- Credit information bureau to be established;
- The Reserve Bank should have the responsibility for off-site and on-site supervision of MFIs;
- A four pillar approach comprising of MFIs, Industry associations, banks and RBI for monitoring compliance of regulations suggested;
- NBFC-MFIs should be exempted from the provisions of the Money-Lending Acts, in view of the recommendation on interest margin caps and increased regulation.

Missing point of Malegam Commitee Report

- Though the committee deals with the issue of regulations MFI's ,it has not defined their role in financial inclusion.
- The Panel's recommendations to tackle multiple lending and excessive borrowing are difficult to enforce.

- The panel fails to appreciate the obivious fact that banks ,not MFI's should lead the way to the goal of financial inclusion.

CONCLUSION

Improving access to finance for India's rural poor, to meet their diverse financial needs (Savings, Credit, Insurance, etc.) through flexible products at competitive rates presents a formidable challenge in a country as vast and varied as India. After six decades of banking in Independent India, the questions that needs to be asked is not whether MFI's are doing good enough job, but whether there's a better alternative to them.

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