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Micro Finance: A Tool Towards Anti Poverty Alleviation for Rural India

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ABSTRACT

In country like India, microfinance has been viewed as a tool of development which would alleviate poverty and enhance the growth of the country through financial inclusion. One of the greatest challenges before the Indian sub- continent which accommodates more than one-third of the population is poverty. Microfinance may be defined as an umbrella under which financial services including micro credit are provided to the low income group. India is the second largest country in the world from population point of view and around seventy percent of its population live in rural areas. Sixty percent of people depend on a single source of income i.e. agriculture. It is not enough to provide food to more than one individual. The present paper will focus on the conceptual framework of microfinance institutions in India, challenges and opportunities of micro finance activities in rural areas of our country,types of microfinance institutions, benefits extended by microfinance institutions, problems of microfinance institutions and future prospects of microfinance institutions in India..

KEYWORDS: ***Mircofinance, Poverty Alleviation, Microfinance Institutions, SHGs.***

INTRODUCTION TO MICROFINANCE

Micro Finance may be defined as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi urban or urban areas, for enabling them to raise their income levels and improve living standards." At present, a large part of micro finance activity is confined to credit only. Women constitute a vast majority of users of micro-credit and savings services. Microfinance sector has grown rapidly over the past few decades. Nobel Laureate Mohammad Yunus is credited with laying the foundation of the modern MFIs with establishment of Grameen Bank, Bangladesh in 1976. Today it has evolved into a vibrant industry exhibiting a variety of business models. Microfinance Institutions (MFIs) in India exist as NGOs (registered as societies or trusts), Section 25 companies and Non-Banking Financial Companies (NBFCs).Commercial Banks, Regional Rural Banks (RRBs), cooperative societies and other large lenders have played an important role in providing refinance facility to MFIs. Banks have also leveraged the Self-Help Group (SHGs) channel to provide direct credit to group borrowers.

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Microfinance can be called a novel approach to provide saving and investment facility to the poor around world. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smoothen their consumption, manage their risks better, gradually build their asset base, develop their business, enhance their income earning capacity, and enjoy an improved quality of life

SALIENT FEATURES OF MICROFINANCE:-

- Borrowers are from the low income group
- Loans are of small amount – micro loans
- Short duration loans
- Loans are offered without collaterals
- High frequency of repayment
- Loans are generally taken for income generation purpose

OBJECTIVES OF THE STUDY

- To understand the concept of micro finance.
- To examine the trends and pattern of Micro finance institutions in India.
- To analyse the framework of Microfinance programme in Rural India by MFIs.
- To study the importance and role of microfinance in poverty elimination.
- The changing scenario of microfinance industry in India.
- The steps taken up by the government and RBI to promote microfinance sector.

RESEARCH METHODOLOGY

Secondary data was conducted to review the present status of micro finance in India. The information and data for the research may be collected through secondary resources i.e. published articles, news papers, journals, reports, books and websites. Data has been collected from the website of Reserve Bank of India and also taken from various committee reports submitted to Government of India on micro finance.

REVIEW OF LITERATURE

Review of Literature plays a very vital role in the investigation of any research paper. There are a lot of thoughts and guidelines have been come into the mind after considering the literature review related to microfinance. Some important thoughts and guidelines have been defined through review of literature. Emerlson Moses has studied that micro finance has emerged as a catalyst of rural development, especially in the overpopulated country like India. S.Sarumathi and Dr. K. Mohan found that microfinance brought psychological and social empowerment than economic empowerment. Impact of micro finance is appreciable in bringing confidence, courage, skill development and empowerment. Devraja T.S. has studied the India's achievement of the MDG of halving the population of poor by 2015 as well as achieving a broad based economic growth also hinges on a successful poverty alleviation strategy. In this backdrop, the impressive gains made by SHG-Bank linkage programme in coverage of rural population with financial services offers a ray of hope. In a similar study Mr. Nikhil considered that the microcredit movement has proved that it is possible to deliver financial services to poor people living in rural areas at a large scale, free from any reliance on subsidies. Manisha Raj, in his research paper entitled "Microfinance Institutions in India and its Legal Aspects" states that Microfinance institutions have been proved a very important financial wing to incorporate the poor in the financial sector. Now on the other aspect like the challenges faced by the microfinance institutions. Mr Badrudduza found the positive results shown by MFIs in many countries but still there are a number of challenges before the microfinance industry, he shown in his paper. Rajesh and Ravi states in their paper, despite the role of microfinance is very good in poverty alleviation but the unethical and extortionist practices by MFIs led to arguably a draconian measure in its

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home turf Andhra Pradesh halting the industry in its tracks. In the line of challenges Dr. Sidhatha and their co authors found that the Microfinance delivery involves macro and micro challenges. The macro challenges faced by MFIs include the inaccessibility of the micro finance services to the rural poor, the capital inadequacy of the MFIs, the demand supply gap in provision of microcredit and micro savings and the lack of women orientation in marketing, evaluation and delivery of microfinance. The micro challenges include the inability to reduce the high transaction cost involved in delivering microfinance, the non-availability of documentary evidence and collateral among majority of rural poor, difficulty in reducing the dependency of the rural poor on money lenders and lastly the problem of repayment tracking where lending is not based on documentary evidence. K. Muralidhara Rao found in his paper that Private MFIs in India, barring a few exceptions, are still fledgling efforts and are therefore unregulated. Jonathan Morduch and Stuart Rutherford in his study "Microfinance: analytical issues for India" states that the microfinance movement is thus striving to match the convenience and flexibility of the informal sector, while adding reliability and the promise of continuity and in some countries it is already doing this on a significant scale.

GROWTH OF MICROFINANCE IN INDIA:

- MFIs operate in 517 districts in India spread across 27 states The total MFI client outreach as of March 2011 was 3.17 crores, while the total microcredit outstanding was Rs. 2500 crores which have been scrutinized to banks .
- During 2010-11, the microfinance through MFI channel has grown 18.75 percent in 2011 in terms of client outreach and 13.15 percent in terms of credit portfolio.
- This year loan portfolio growth rate has decreased to 13.15 percent compared to 56 percent in the previous year.
- MFIs collectively disbursed Rs. 33730 crores as loans to clients during 2010-11. Also, the average loan per client stood at Rs. 5706, which is less than that of Rs.9766 in the last year.
- In 2010-11, more than one third of the MFIs displayed negative growth in client and loan portfolio

MODES OF DELIVERY OF MICROFINANCE

Micro Finance Institutions (MFIs) around the world follow a variety of different methodologies. The focus of such service is women rather than men for the reason women are more judicious and economical to men. The following are major methodologies employed by MFIs for delivery of financial services to low income families.

SELF HELP GROUPS (SHGS)

The Self Help Groups (SHGs) is the dominant microfinance methodology in India. In this case the members of Self Help Group pool their small savings regularly at a prefixed amount on daily or weekly basis and SHGs provide loan to members for a period fixed. SHGs are essentially formal and voluntary association of 15 to 20 people formed to attain common objectives. People from homogenous groups and common social back ground and occupation voluntarily form the group and pool their savings for the benefit of all of members of the groups. External financial assistance by MFIs or banks augments the resources available to the group operated revolving fund. Saving thus precede borrowing by the members. NABARD has facilitated and extensively supported a program which entails commercial banks lending directly to SHGs rather than via bulk loan to MFIs. If SHGs are observed to be successful for at least a period of six months, the bank gives credit usually amounting 4 times more than their savings.

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INDIVIDUAL BANKING PROGRAMMES (IBPS)

In Individual Banking Programmes (IBPs) there is provision by Microfinance institutions for lending to individual clients though they may sometimes be organized into joint liability groups, credit and saving cooperatives. This model is increasingly popular through cooperatives. In cooperatives, all borrowers are members of organization directly or indirectly by being member of cooperative society. Credit worthiness and loan securing are a function of cooperative membership in which member's savings and peer pressure are assumed to be key factors. BAXIS a MFI based in Ahmadabad, offers both the joint liability group and individual lending loans in addition to loans to intermediaries. Bank of Rakyat at Indonesia, arguably the world's biggest and profitable microfinance institution is following this model.

GRAMEEN MODEL

Grameen Model was pioneered by DR Mohammed Yunus of Grameen Bank of Bangladesh. It is perhaps the most well known and widely practiced model in the world. In Grameen Model the groups are formed voluntarily consisting of five borrowers each. The lending is made first to two, then to the next two and then to the fifth. These groups of five meet together weekly, with seven other groups, so that bank staff meets with forty clients at a time. While the loans are made to the individuals, all in the group are held responsible for loan repayment. According to the rules, if one member ever defaults, all in the group are denied subsequent loans.

MIXED MODEL

Some MFIs started with the Grameen model but converted to the SHG model at a later stage. However they did not completely do away with Grameen type lending and smaller groups. They are a mix of SHG and Grameen model. The main difference between these programs is rather marginal. Grameen programmes have traditionally not given much importance to savings as a source of funds where as SHGs place considerable emphasis on the source of funds. The SHG programs have compulsory deposit schemes in which the members themselves determine the amount. The SHGs model is widely used in India. According to Vijay Mahajan (2003), Managing Director of BASIX, the SHGs and Grameen models offer economies of transaction cost to MFIs, but at the cost of members time because the unit of dealing is "group" rather than individual. In contrast, MFIs offering individual loans incur higher transaction costs for serving their borrowers.

A BRIEF PROFILE OF RURAL INDIA

- 350 million Below Poverty Line
- 95 % have no access to microfinance.
- 56 % people still borrow from informal sources.
- 70 % don't have any deposit account.
- 87 % no access to credit from formal sources.
- Annual credit demand is about Rs.70, 000 crores.
- 95 % of the households are without any kind of insurance.
- Informally Microfinance has been in practice for ages

ROLE OF MICROFINANCE IN POVERTY ALLEVIATION

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 needs 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

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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. Formal financial institutions have little incentives to lend to the rural poor for the following reasons.

Formal financial institutions have little incentives to lend to the rural poor for the following reasons.-

- **Administrable difficulties:** Small rural farmers often live geographically scattered, in areas with poor communication facilities, making loan administration difficult.
- **Systematic risks:** Agricultural production is associated with some systemic risks, such as drought and floods, which is reflected in a high covariance of local incomes.
- **Lack of information:** The absence of standardized information, Standard lending tools, such as financial statements or credit histories, do not exist in these areas.
- **Repayment problems:** The repayment of working capital may be required only once a year for example during the harvest season. On the other hand, access to informal loans is relatively easy, convenient, and available locally to low income households for the following reasons:-

➢ Informal moneylenders use interlinked credit contracts to reduce default risk such as development of business relationship with the clients.

➢ Informal moneylenders have local information which helps them to appraise credit needs and credit worthiness of the client.

➢ Informal moneylenders are considering the needs and requirements of clients even for small amount of loan.

➢ Informal moneylenders will profit from social sanctions such as those that may exist among members of a family. These sanctions may serve as a substitute for legal enforcement.

➢ Informal moneylenders use specific incentives to stimulate repayment, such as repeat lending to borrowers who repay promptly, with gradually increasing loan size.

PROBLEMS OF MICROFINANCE INSTITUTIONS IN INDIA

- Low Outreach
- Loan Default
- Low Education Level
- Language Barrier
- Late Payments
- Geographic Factors
- Uneven Population Density
- Quality of SHGs
- Regional Disparity
- Low Depth of Outreach
- Unregulated Microfinance Institutions
- Lack of Insurance Services
- High Interest Rate
- Negligence of Urban Poor
- Debt Management
- High Transaction Cost
- Lack of access to Funding
- Loan Collection Method
- Fraud
- Deserving Poor are Still not Reached

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RECOMMENDATIONS AND SUGGESTIONS TO IMPROVE THE WORKING OF MICROFINANCE INSTITUTIONS IN INDIA

- Proper Regulation
- Field Supervision
- Encourage rural penetration
- Complete range of Products
- Transparency of Interest rates
- Technology to reduce Operating Cost
- Alternative sources of Fund

RECOMMENDATIONS BY RBI MICRO-CREDIT INSTITUTIONS

There are underlined recommendations proposed by RBI:

- Company Law Board to allow SHGs to be members of the Section 25 of the companies act
- There will be no ceiling in respect of loan amount extended by Section 25 companies to self help groups. However, self help groups may get credit not exceeding Rs 50,000 per member. This is applicable until RBI considers revised instructions on the rule.
- As regards to the capital, to encourage more flow of contributions/donations. Donors to be exempted from income tax under Section 11c of the Income Tax Act.
- As regards to the capital adequacy, minimum standards need not be considered.
- Savings of SHGs promoted by Section 25 companies should be maintained with permitted organizations.
- Complete income tax exemption for Section 25 companies providing micro-credit to the donor and to the receiver.

CONCLUSION

Microfinance is not just about giving micro credit to the poor rather it is an economic development tool whose objective is to assist poor to work their way out of poverty. It covers a wide range of services like credit, savings, insurance, remittance and also non-financial services like training, counselling etc.

The Indian economy at present is at a crucial juncture, on one hand, the optimists are talking of India being among the top 5 economies of the world by 2050 and on the other is the presence of 260 million poor forming 26 % of the total population. The enormity of the task can be gauged from the above numbers and if India is to stand among the comity of developed nations, there is no denying the fact that poverty alleviation & reduction of income inequalities has to be the top most priority. The impressive gains made by SHG-Bank linkage programme in coverage of rural population with financial services offers a ray of hope. The paper argues for mainstreaming of impact assessment and incorporation of local factors in service delivery to maximize impact of SHG –Bank linkage programme and other MFIs on achievement of reduction in poverty and getting this opportunity.

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