MICRO-FINANCE AS AN ANTI-POVERTY VACCINE

ROBIN INDERPAL SINGH*

*Assistant Professor, Dept. of Commerce, Shree Atam Vallabh Jain College, Hussainpura, Ludhiana, India

ABSTRACT

Micro finance is the provision of thrift, credit and other financial services and products of very small amounts to the poor for enabling them to raise their income levels and improve their living standards. It has been recognized that micro finance helps the poor people meet their needs for small credit and other financial services. When understanding the capability of microfinance as an anti-poverty tool, it is important to remember that microfinance is not the only solution to global poverty. So far, it has improved the lives of thousands of families in various countries. That in itself is a great feat that is just as crucial as any other effort directed towards poverty alleviation. By empowering the poor and instilling in them a sense of self-respect, motivation, and drive to move out of poverty and achieve success, microfinance is definitely an effective poverty alleviation tool that has important implications in the future of the world’s low-income populations. It can be said that Micro-Finance is just like a an Anti-Poverty Vaccine.

KEYWORDS: Microfinance, Poverty Alleviation, Microfinance Institutions.

INTRODUCTION

Micro finance is the provision of thrift, credit and other financial services and products of very small amounts to the poor for enabling them to raise their income levels and improve their living standards. It has been recognized that micro finance helps the poor people meet their needs for small credit and other financial services. The informal and flexible services offered to low-income borrowers for meeting their modest consumption and livelihood needs have not only made micro finance movement grow at a rapid pace across the world, but in turn has also impacted the lives of millions of poor positively.

In the case of India, the banking sector witnessed large scale branch expansion after the nationalization of banks in 1969, which facilitated a shift in focus of banking from class banking to mass banking. It was, however, realised that, notwithstanding the wide spread of formal financial institutions, these institutions were not able to cater completely to the small and frequent credit needs of most of the poor. This led to a search for alternative policies and reforms for reaching out to the poor to satisfy their credit needs.
The beginning of the micro finance movement in India could be traced to the self-help group (SHG) - bank linkage programme (SBLP) started as a pilot project in 1992 by National Bank for Agricultural and Rural Development (NABARD). This programme not only proved to be very successful, but has also emerged as the most popular model of microfinance in India. Other approaches like microfinance institutions (MFIs) also emerged subsequently in the country. Recognizing the potential of microfinance to positively influence the development of the poor, the Reserve Bank, NABARD and Small Industries Development Bank of India (SIDBI) have taken several initiatives over the years to give a further fillip to the microfinance movement in India.

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

The Evolution Microfinance in India

The World Bank has called South Asia the “cradle of microfinance.” Statistics indicate that some 45% of all the people in the world who use microfinance services are living in South Asia. However, the overall percentage of the poor and vulnerable people with access to financial services remains small, amounting to less than 20% of poor households in India. The World Bank estimates that more than 87% of India’s poor cannot access credit from a formal source and therefore they are not borrowing at all or have to depend on money-lenders who charge them interest rates ranging from 48% to 120% per annum and sometimes much higher. This demonstrates that there are potential clients for microfinance in India, depending on the level of demand for financial services, from those poor without access to it. The provision of such services, if done correctly, could have a significant impact on the poor. This fact alone is very compelling and is reason enough to occupy oneself with the careful questioning of how microfinance can be provided to as many of the poor with a demand for it as possible. Integral to this questioning is the purpose of this study, understanding the costs
and benefits of providing microfinance in the form of a financial company rather than an NGO.

Historically, credit to the poor in India was viewed as a government program that required large amounts of subsidy. This has changed somewhat in that the trend has been a move towards more commercial forms of financing. This trend has been the product of a long evolution of the financial sector, which can be characterized by three major events.

- The first of these pivotal events was Indira Gandhi’s bank nationalization drive launched in 1969 which required commercial banks to open rural branches resulting in a 15.2% increase in rural bank branches in India between 1973 and 1985. Despite these achievements, there still has been little progress in providing the rural poor with access to formal finance.

- The second national policy that has had a significant impact on the evolution of India’s banking and financial system is the Integrated Rural Development Program (IRDP) introduced in 1978 and designed to be ‘a direct instrument for attacking India’s rural poverty.’ This program is interesting to this study because it was a large program whose main thrust was to alleviate poverty through the provision of loans and it was considered a failure. It therefore provides a comparison of what has failed in the past and how this affects the provision of microfinance through private means today. The IRDP was reputed as one of the largest poverty alleviation programs in the world with the number of loans advanced since its inception having reached approximately 45 million Indians with financial assistance worth US$6.17 billion disbursed. Despite the massive support for the IRDP however, a government evaluation in 1989 revealed that it had not achieved the expected results with only 28% of those assisted under the IRDP crossing the poverty line in contrast to private-sector-led services and business micro-enterprises which performed better with 33% of those involved in the sector that crossed the poverty line.

- The last major event which impacted the financial and banking system in India was the liberalization of India’s financial system in the 1990s characterized by a series of structural adjustments and financial policy reforms initiated by the Reserve Bank of India (RBI). The result was a partial deregulation of interest rates, increased competition in the banking sector, and new microfinance approaches of which the most notable was a movement to link informal local groups called self-help groups (or SHGs) created by NGOs to commercial banks like the National Bank for Agriculture
and Rural Development (NABARD). These financial policy reforms in the 1990s were very significant to microfinance because they involved scrapping the interest rate controls for credit to the poor and other types of credit. These financial liberalization measures then made it possible for NABARD to transform what was then a small research project into a full blown microfinance program for the whole country. This program was better known as the ‘SHG Bank Linkage’ model which has come to be one of the most well known and widespread microfinance models in India. Since many consider the SHG Bank Linkage model of microfinance to be one of the major successes of microfinance delivery in the country it will provide the most important direct contrast to the delivery of microfinance services by individual MFIs.

**Channels of Micro finance**

In India microfinance operates through two channels:

- **SHG – Bank Linkage Programme**: This is the bank-led microfinance channel which was initiated by NABARD in 1992. Under the SHG model the members, usually women in villages are encouraged to form groups of around 10-15. The members contribute their savings in the group periodically and from these savings small loans are provided to the members. In the later period these SHGs are provided with bank loans generally for income generation purpose. The group’s members meet periodically when the new savings come in, recovery of past loans are made from the members and also new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular. The SHGs are self-sustaining and once the group becomes stable it starts working on its own with some support from NGOs and institutions like NABARD and SIDBI.

- **Micro Finance Institutions**: Those institutions which have microfinance as their main operation are known as micro finance institutions. A number of organizations with varied size and legal forms offer microfinance service. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee. The reason for existence of separate institutions i.e. MFIs for offering microfinance are as follows:
• High transaction cost – generally micro credits fall below the break-even point of providing loans by banks
• Absence of collaterals – the poor usually are not in a state to offer collaterals to secure the credit
• Loans are generally taken for very short duration periods
• Higher frequency of repayment of installments and higher rate of Default

Non-Banking Financial Companies (NBFCs), Co-operative societies, Section-25 companies, Societies and Trusts, all such institutions operating in microfinance sector constitute MFIs and together they account for about 42 percent of the microfinance sector in terms of loan portfolio. The MFI channel is dominated by NBFCs which cover more than 80 percent of the total loan portfolio through the MFI channel.

Micro finance as a Poverty alleviation tool:
One such poverty alleviation tool is microfinance, which has gained worldwide recognition since the 1990s and has been proven to have positive effects on poverty levels in developing countries.

• Obtaining of collateral-free loans: Microfinance is the provision of financial services to the poor, aiming to empower low-income populations by providing them with access to credit and other financial services. Through microfinance institutions (MFI), the poor can obtain collateral-free loans at relatively low interest rates and use the money for creating microenterprises (small businesses owned by poor people), funding children’s education, and improving homes, among others.

• Developing of financial products: Aside from microcredit (small loans to the poor), MFIs have also developed numerous financial products, such as micro-insurance and micro-mortgage that are designed to accommodate the poor’s financial needs.

• Most of these institutions have also required their clients to open up savings accounts, which could be used for emergency and investment purposes

• Training and group meetings are also essential elements in microfinance. Once an individual chooses to borrow loans from MFIs, person is required to attend these activities and participate in capacity building programs. Entrepreneurship and risk management skills, credit discipline, values formation, information on health and hygiene, among others are discussed and taught in these training sessions to equip the borrower with proper knowledge of effectively managing their small business and aid
there in everyday living. Through this approach, MFIs are not only able to provide financial capital to the poor, but they are also able to promote a sense of responsibility and drive to achieve success in entrepreneurial endeavors.

- Women Empowerment: Aside from obtaining access to credit and other financial services, and creating microenterprises that provide employment, the poor also gain additional benefits that contribute to their overall economic improvement and social mobility. In most third-world countries in which MFIs operate, women empowerment is one of the most important effects that microfinance generates in rural communities. By acquiring access to financial capital and starting their own family business, women increase their decision-making power in the household and are able to possess skills in entrepreneurship and financial management. They gain more knowledge in terms of running their own source of livelihood and do not remain as ordinary housewives solely tied to the responsibility of taking care of their families. They start to play important roles in their communities and receive respect from other people for proving their great capacity to effectively manage resources and organize microenterprises. The benefits that women obtain from microfinance are not only financial but also encompass gender empowerment and self-actualization. In rural areas and villages, which are traditionally patriarchal, women are given the opportunity to uplift their status in the society and prove their worth as capable members of their community.

- Social Mobility: The poor in general experience social mobility through microfinance. As they acquire access to credit and become included in the financial sector, they are able to improve their economic status and increase their participation in the domestic (or even global) market. There is relationship between financial sector development and poverty alleviation. The financial sector has direct effects on the economic condition of the poor

**Problems of Microfinance Programme**

No doubt, microfinance programme has shown impressive achievements, but a number of questions arise: Did this programme reach the underprivileged? Whether everyone in need of microfinance intervention had been reached by any of the agencies? Even if everyone had been reached, did they get the required quantum of assistance to have sustainability? These
questions are still very inconvenient to be answered because there are certain problems associated with this programme.

- **Deserving Poor are Still not Reached:** The microfinance delivery models are not exclusively focused on those who are below the poverty line or very poor. Though the programme is spreading rapidly but with a slow progress in targeting the bottom poor households.

- **Regional Disparity:** It has been observed that the microfinance programme is mainly run by formal financial institutions with the help of SHGs. As a result, microfinance programme is progressing in those areas of the country where there is tremendous growth of formal financial institutions. Microfinance institutions were expected to reach those areas where the formal banking system failed to reach and the poor people have to depend on the money-lenders in order to meet their financial requirements. But actually, many big MFIs are activate in those states where the banking network is very strong.

- **High Interest Rates:** Affordability of loan is equally important to the access of financial services to the poor. Economic fundamentals exhort that every borrower is interest sensitive and the capacity of borrowing decreases with increase in interest rates. High interest rates may prove to be counterproductive, and weaken the social and economic condition of poor clients. The high interest rate charged by the MFIs from their poor clients is perceived as exploitative.

- **Low Depth of Outreach:** Another problem faced by the microfinance programme is the depth of services provided. Though the outreach of the programme is expanding, large numbers of peoples are provided with microfinance services but the amount of loans is very small.

- **Unregulated Microfinance Institutions:** In India, micro finance is provided by a variety of institutions. These include banks (including commercial banks, RRBs and co-operative banks), primary agricultural credit societies and MFIs that include NBFCs, Section-25 companies, trusts and societies. But only the banks and NBFCs fall under the regulatory purview of the Reserve Bank of India. Other entities, e.g., MFIs are covered in varying degrees of regulation under their respective State legislations. There is no single regulator for this sector. As a result, MFIs are not required to follow some standard rules and are not subject to minimum capital
requirements and prudential norms. This has weakened their management and governance, as they do not feel it mandatory to adopt some specific systems, procedures and standards.

- **Lack of Insurance Services:** Poor people are vulnerable to financial shocks. A small change in their earning patterns due to natural calamities, health problems, death of earning member etc. can push them to destitute. So, a provision of insurance under the microfinance programme is very essential to help the poor to cross the poverty line. But, in reality, the current microfinance programme in India is just focused on regular saving and micro-credit. SHG-BLP developed by NABARD is also providing saving and credit services mainly and the provision of insurance is very less.

**Conclusion**

Despite the positive benefits incurred by the poor, microfinance has its own issues and criticisms. Microfinance’s real impact on alleviating poverty at the global level is not supported by rigorous research, as critics claim. Stories of success are also not enough to accurately measure the extent to which microfinance has impacted the poor. MFIs are also criticized for charging high interest rates in the pursuit of becoming self-sustainable organizations because this decision ultimately affects their impoverished clients and borrowers. When understanding the capability of microfinance as an anti-poverty tool, it is important to remember that microfinance is not the only solution to global poverty. One cannot expect microfinance to singlehandedly eradicate poverty in the world as there are other variables aside from economic factors that contribute to the prevalence of poverty in our society. Just like any other anti-poverty program, microfinance has its own limitations and weaknesses, but this does not mean that efforts in promoting this financial tool must be completely abandoned. So far, it has improved the lives of thousands of families in various countries. That in itself is a great feat that is just as crucial as any other effort directed towards poverty alleviation. By empowering the poor and instilling in them a sense of self-respect, motivation, and drive to move out of poverty and achieve success, microfinance is definitely an effective poverty alleviation tool that has important implications in the future of the world’s low-income populations. It can be said that Micro-Finance is just like a Anti-Poverty Vaccine.
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