Influence of Micro Finance on Poverty Alleviation for the Upliftment of the Rural India

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Abstract: 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 which fight against global poverty. The main benefits of micro-credit appear to be reduced vulnerability of the poor to adverse circumstances, increased consumption in the same group and empowerment of women. Fortunately, micro-finance practice in India like some other countries has much to offer to the rural population. These include poverty alleviation, livelihood promotion, developing the local economy, gender empowerment, building organizations and changing wider systems and institutions within society. SHG-banking linkage model is an important model of micro-finance which helps their members to start their own business. Poverty and Unemployment are the major problems of underdeveloped countries to which India is no exception. India suffers from substantial poverty.

The powerful push behind this huge and increasing support for microfinance indicated that national economic and social impacts are significant and it needs to be examined more closely. This paper argues that microfinance can be considered an important element for an effective poverty reduction strategy. It shows that access and efficient provision of microcredit can enable the poor to smooth their consumption, manage their risks better, gradually build their assets, develop their micro enterprises, enhance their income earning capacity and enjoy an improved quality of life. The present paper discusses conceptual framework, development process, Picture of Rural India as a profitable segment for microfinance institutions, the importance and role of microfinance in poverty elimination, growth of SHG linked microfinance programme.

Key words: micro finance, Poverty, Unemployment, Self help Group, Micro credit

Introduction

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. Before the microfinance sector, people around the world have been borrowing and saving using various sources outside of the formal financial sector. Informal financial services ranging from loan providers, community members and saving groups were once the only source for low income individuals who were unbanked or under banked. Such sources are still commonly used in both rural and urban areas, but now microfinance is a new source for loans, savings and insurance for those Indians who do not have access to any type of financial services and the Indians who might be unhappy with the informal financial services they use.

Objectives

1. To study the importance and role of microfinance in poverty elimination.
2. To analyze the growth of microfinance sector developed in India and see potential for the microfinance institutions,SHGs in the market.
3. To understand the relationship between micro-credit and poverty alleviation

Review of literature

Nasir S (2013) tries to outline the prevailing condition of the microfinance in India in the light of its emergence till now and its aim is to provide a
cost effective mechanism for providing financial services to the poor. The research finding discovers the prevailing gap in functioning of MFIs such as practices in credit delivery, lack of product diversification, customer overlapping and with practicable suggestions to overcome the issues and challenges associated with microfinance in India.

Hulme and Mosley (1996) in a comprehensive study on the use of microfinance to combat poverty, argue that well-designed programmes can improve the incomes of the poor and can move them out of poverty. They state that “there is clear evidence that the impact of a loan on a borrower’s income is related to the level of income” as those with higher incomes have a greater range of investment opportunities and so credit schemes are more likely to benefit the “middle and upper poor”. Concern (2003) aims for a holistic analysis and understanding of the root causes of poverty and how people cope with poverty. They identify livelihood shocks such as natural disasters and drought, the social, political and economic context, and people’s livelihood resources such as education and local infrastructure as factors affecting people’s livelihood security. Therefore, when analysing the impact of microfinance is having on livelihood security, as is the objective of this dissertation, an holistic analysis of people’s livelihood security must be conducted, rather than just focusing on the material/economic impact microfinance is having on the livelihoods of the poor.

Mayoux (2001) states that while microfinance has much potential, the main effects on poverty have been: credit making a significant contribution to increasing incomes of the better-off poor, including women and microfinance services contributing to the smoothing out of peaks and troughs in income and expenditure thereby enabling the poor to cope with unpredictable shocks and emergencies.

Knight and Farhad (2008) mentioned that microfinance directly improves quality of life and promotes poverty reduction. By getting loans the client become self employed and protect himself for the external threats. By getting employment they become raised from the poverty line and the poverty decreased. Micro finance is in the initial stages and in these stages most of the peoples do not know about the reality of micro finance. Some peoples take that example of micro finance where the result of micro finance is negative. It is more important that the examples where the result of micro finance is more positive then negative should be highlighted so that more and more peoples get benefit from micro finance and cross the poverty line.

Kumar, Bohra & Johari (2008) found that microfinance is the only way to overcome poverty in India. A great potential exist for micro finance in the country. Major cross-section can have benefit if this sector will grow in its fastest pace. An annual growth rate of about 20% should be continuing if they want to control poverty. At present, the outstanding balance is 1600 crores. This amount should be increase to 42,000 crores in next five years.

Rena, Ravinder and Tesfy, Ghirmai (2006) concluded that micro finance is the founding stone for poverty reduction. Their study showed that there is a fundamental linkage between microfinance and poverty eradication, in that the latter depends on the poor gaining access to, and control over, economically productive resources, which includes financial resources. Previously implemented programs not produced good results due to the non involvement of the peoples for which the programs was designed. They suggested that the government poverty alleviation program should be restructured if not re-designed and should be centered on the basic need approach. Micro finance is the mean for income generation and the way for permanent reduction of poverty through the provision of health services, education, housing, sanitation water supply and adequate nutrition. In many instances, micro enterprises rather than formal employment create an informal economy that comprises as much as 75 per cent of the national economy.

Mawa (2008) conducted a research study focusing the issue under discussion and concluded that microfinance is an innovative step towards alleviating poverty. The author mentioned that microfinance facilities provided to the people help them to use and develop their skills and enable them to earn money through micro enterprises. Moreover provision of micro finance helps them to smooth their consumption level and manage unexpected risks. Micro finance helps the poor to built assets, educate their children and have a better quality of life.

**Research Methodology**

This is a descriptive research paper based on secondary data. Data have been found out from different websites, books, research paper and journals collected.
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. 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 not straightforward, 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 interlinked 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.

- 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.

Limitation of Informal money lending system

A common feature of many rural communities is that much of the local information does not flow freely; it tends to be segmented and circulates only within specific groups. Usually the informal credit market is based on local economies and is thus limited by local wealth constraints and the covariant risks of the local environment. Since most of the world’s poor do not have access to basic financial services that would help them manage their assets and generate income. To overcome poverty, they need to be able to borrow, save, and invest, and to protect their families against adversity. Another shortcoming of the two financial sectors in developing countries is their inability to satisfy the credit needs of the poor that has led to the new development of microfinance. Microfinance is believed to be able to reduce the above-mentioned inadequacies of formal and informal financial institutions and is emerging as an important credit partner to the poor in the developing world.

Poverty Alleviation Programmes in India:

A number of recent studies in India have revealed that self-employment programmes suffered from leakages of various kinds such as high percentage of non-poor beneficiaries, poor quality of assets acquired/delivered and high transaction cost. Another issue pertains to the effectiveness of self-employment programmes in generating additional
income for the beneficiaries. The initial increase in income from such activities is often not sustained over a long period. There are cases of outright misappropriation of funds or more likely the assets provided for the self-employment venture, namely, milk cattle, goats, pump sets, sewing machine etc. have been sold in a relatively short time and the proceeds consumed. Poor households may be compelled to sell even an asset which is earning a reasonably high rate of return in times of distress because it cannot get access to credit to tide over temporary difficulties. A serious problem in the implementation of a credit-based self-employment scheme is that an impression is often created among the beneficiaries that the credit does not need to be repaid, leading to unavoidable overdues. The poor performance of most of the poverty alleviation schemes is due to poor follow-up and monitoring of activities of the loan recipient by the implementing agencies. The success of most of the self-employment programmes heavily depends on the factors outside the purview of the programmes such as beneficiary capacity, infrastructure and markets, which are a function of overall socio-economic development. Hence, they do not succeed among the socially and the poorly endowed households and the less developed areas. Most beneficiary households were not able to raise their income to that extent to cross the poverty line and on a sustainable basis owing to low amount of investment and absence of infrastructure and linkages necessary to start and sustain enterprises. The quality of the assets created under wage employment programmes in the past has been poor and the assets are typically not durable. This has been repeatedly found in the case of rural roads built under these programmes which are either washed away or deteriorate after every monsoon season. The wage employment programmes which were aimed at creating productive assets have also been criticized on the ground that the assets created, such as irrigation works or even roads, ultimately enhance the value of land and the benefits and therefore, accrue mainly to upper-income-land-owning-groups and not to the poor. These programmes have not been as successful as they should have been in ensuring that resources are devoted to potentially productive works such as renovation of tanks, minor irrigation works and soil conservation. Such works constitute investment activity which could greatly raise land productivity and enhance the long term employment generation capacity of local agriculture. However, this can only be achieved if the employment programmes are integrated with designed area and watershed plans in which specific works are clearly identified for implementation through employment programmes. This demands considerable expertise in field-level planning and a high degree of organizational efficiency at the implementation level. Wage employment programmes are meant to provide only short term employment, and would need to be repeated every year, as they can only alleviate current poverty and do not lead to an improvement in the capability of the poor to generate incomes on a sustained basis. The World Bank study (1998) disclosed that wage employment programmes of India were by and large the most effective in reaching the poor, while the self-employment programmes ranked with a relatively higher proportion of non-poor beneficiaries. Two aspects of mis-targeting in poverty alleviation programme have been identified by the Saxena Committee i.e. exclusion of large number of poor families from the list of potential beneficiaries of poverty alleviation programmes and inclusion of ineligible categories or the non-poor in the programme

Self Help Groups

India has been experiencing micro credit in the form of Self-Help Groups (SHGs) as a part of formal credit delivery system giving lot freedom to Non Government Organizations (NGOs) to set up SHGs on various models. The self-help group is a registered or unregistered group of wall and economically homogeneous and affinity group of poor. Voluntarily coming together to save small amounts regularly, to mutually help basis, which are deposited in a common fund to meet members emergency needs and to provide collateral free loans decided by the group. They have been recognized as useful tool to help the poor and as alternative to meet the urgent credit needs of poor through thrift. SHGs enhance the equality of status of women as participants, decision-makers and beneficiaries in the democratic, economic, social and cultural spheres of life

SHGs go through various stages of evolution:

a) Group formation: At this stage, groups are formed, developed and strengthened to evolve into self-managed people's organisations at the grassroots level.

b) Group stabilization: through thrift and credit activity among the members and building their group corpus-the group takes up internal loaning to the members from the corpus.

c) Micro credit : The group corpus is supplemented with Revolving Fund sanctioned as cash credit limit by the banks to take livelihood.

d) Micro enterprise development: Here, the group takes up economic activity, of its choice for income-generation.

The groups are eligible for the loans from the banks after six month of saving and credit operations. The
banks assess the strengthen of the groups in terms of successful rotation of saving of the groups as loans, regularity in conducting and attending meeting savings mobilization numbers of loan issued to the groups as replacement of loans. The opportunity provided in safe saving as well as availability of need-bases credit has led to more and poor people keen to join SHGs. The members use the credit for a variety of purposes like small business, agriculture, health, education of children, festivals and so on.

The Constraints

1. 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.

2. 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.

3. 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.

Conclusion

The potential for growing microfinance institutions in India is very high. Major cross-section can have benefit if this sector will grow in its fastest pace. Microcredit and microfinance have received extensive recognition as a strategy for poverty reduction and for economic empowerment. Microfinance is a way for fighting poverty, particularly in rural areas, where most of the world's poorest people live. Accessing small amounts of credit at reasonable interest rates give poor people an opportunity to set up their own small business. Many studies show that poor people are trustable, with higher repayment rates than conventional borrowers. It is important that the microfinance programme spread more evenly so that the benefits are available especially in regions where the need is more accurate. The challenge for NGOs and MFIs is to achieve their own financial self-sufficiency without transferring all the overhead costs to their poor clients. They need to ensure sufficient investment to provide diversified livelihood options and employment creation by optimizing existing resources through timely credit, technical inputs, skill training and knowledge transfer. Many studies reveal that increased availability of micro-credit to the poor through SHG bank linkage program will help rural people to take up larger productive activities and decrease the dependence on money lenders. But, In spite of the impressive figures of micro-finance in India as have exposed in tables. It is still too small to create a massive impact in poverty alleviation. However, Indian experience in the case of Microfinance and SHG is shown that this strategy is suitable strategy for developing and underdeveloped countries against poverty.

References


