A STUDY OF ROLE OF MICROFINANCE IN POVERTY REDUCTION

PROF. (DR.) RAJESH K. YADAV[1], Ms. MEETA RAGHUVANSHI[2]
[1]Professor & Director, School of Management, JagranLakecity University, Bhopal (M.P.)
[2]Research Scholar, Faculty of Management, Barkatullah University, Bhopal (M.P.)
Email - drrajeshkyadav@jlu.edu.in, raghuvansh_meet@yahoo.co.in

Abstract: *In India where 70 per cent of its population exists in rural area and 60 per cent depend on agriculture (according to the World Bank reports), micro-finance can play a very important role in providing financial services to the poor and low income individuals. The present paper highlights the microfinance & evaluates the position of micro-finance in Indore districts MP. The concept of microfinance is not new in India. MFI's clients get a wide range of financial services such as deposits, loans, payment services, money transfers, insurance, savings, micro-credit etc.There are two broad methods that describe the microfinance sector in India is Self Help Groups (SHGs), and Microfinance Institution (MFIs). This study is objects to finding the current status and role of microfinance in Indore. The study discovers some suggestions to make microfinance more effective. On the basis of growth and evolution related to microfinance, this paper forecasts the new program for future. This paper evaluates the different aspects of microfinance in Indore districts of MP.*

Keywords: *concept of microfinance, poverty reduction, nature of microfinance.*

1. INTRODUCTION:

In India, despite the economic growth at national level at 9.4% in 2006-07 it has declined to around 6% in 2008-09, poverty remains a serious problem for policy makers because the growth is mainly driven by growth in a few sectors in urban areas, such as industry and service sectors.

Micro finance hitherto remains a powerful tool for development. It may be a universal remedy, but it has brought many changes in the lives of many rural poor people. By reaching the un-reached rural poor in the rural regions, micro finance innovations are yielding results and giving promise to the millions of poor through providing credit.

With financial inclusion budding as a major policy objective in the country, Microfinance has occupied centre stage as a promising mechanism for extending financial services to unbanked sections of the population.

These institutions giving their financial services to low-income borrowers or similar lending groups, including consumers and the self-employed, who are excepted from all required of financial services. Microfinance provides various types of products to the poor and it is a very important financially development tool whose objective is to provide work to poor peoples and help to removing poverty. It covers a wide range of services like financial as well as non-financial services.

2. DEFINITION OF MICROFINANCE:

A good definition of microfinance as provided by Robinson is, 'Microfinance refers to small-scale financial services for both credits and deposits —that are provided to people who farm or fish or herd;

Various scholars defined the term 'microfinance' in the following manner:

- Microfinance is defined as the provision of thrift, credit and other financial services such as money transfer and micro-insurance products for the poor, to enable them to raise their income levels and improve living standards.
- 'Microfinance refers to the provision of financial services to low-income poor and very poor self-employed people'.
- Microfinance can be defined as the provision of legitimate small businesses and individuals who have limited access to traditional banking services, financial and supplementing those social services aimed in terms of macroeconomic effect on the smoothing of social tension in society, improving living standards, employment, development of entrepreneurship.

In India, microfinance operates basically through two channels:
1. SHG – Bank Linkage Programme (SBLP)
2. Micro Finance Institutions (MFIs).

In India, Self Help Groups or SHGs represent a unique approach to financial intermediation. The approach combines access to low-cost financial services involving a process of self-management, with an objective of social and economic development for the women SHG members.

SHG-Bank Linkage programme is a revolutionary step of financial inclusion in rural areas of India. The number of saving linked SHGs now stands at 74.3 lakhs with a membership of over 96.6 million poor households.

3. EVOLUTION OF CONCEPT OF MICROFINANCE:

Early traces of microfinance can be related back to the informal savings and credit groups that have operated for the poor, centuries ago. This include the 'susus' of Ghana, 'chit funds' in India, 'tandas' in Mexico, 'arisan' in Indonesia, 'cheetu' in Sri Lanka, 'tontines' in West Africa and 'pasanaku' in Bolivia. In 1700s, the Irish author Jonathan Swift initiated the earliest form of modern MFIs—the Irish loan fund system. The Irish loan fund system was designed to provide small uncollateralized loans to rural poor. In 1800, various other formal institutions began to emerge in Europe in the forms of people's banks, credit unions and savings and credit co-operatives. Of these, the credit unions developed by Friedrich Wilhelm Raiffeisen gained wide acclaim in Europe and other North American States, in relieving the rural poor from the clutches of usurious moneylenders. In 1895 people's banks became popular in Indonesia, and in 1900 the idea spread to Latin America.

The seeds for microfinance in its current form were planted during the period 1950–80, when small loans were extended to poor borrowers who could not post meaningful collateral. Major organizations, which pioneered this initiative, were ACCION International in Latin America, SEWA Bank in India and the Grameen Bank founded by Muhammad Yunus in Bangladesh. These initiatives demonstrated for the first time that poor borrowers, especially women, were not only willing to take on small scale projects funded by loans, but were also capable of chalking up excellent payment records.

In the early stages of evolution, microfinance was largely restricted to loans and was funded by either governments or aid agencies and was thus based on "soft capital." Since the 1990s, microfinance has branched out both in terms of the range of financial and economic services extended, as well as in terms of how capital is raised. Banks began to access this market in a more significant way than ever before. Financial services ranging from savings deposits, loans, insurance to cover life, health, crop, and properties are currently offered. Many microfinance institutions access capital markets either by issuing equity or debt capital in order to raise capital. There are others who have been able to securitize their loans and thus attract capital by issuing micro-credit backed securities. Technological innovations have also paced the evolution of microfinance: widespread availability of mobile phones, access to community-level kiosks of computer terminals with access to the Internet, biometric technology to obtain loan approval and credit history, and correspondent banking have dramatically changed the landscape of microfinance. The year 2005 was declared as the "Year of Microfinance," and a number of private sector enterprises and foundations have now dedicated pools of capital for exclusive investments in the area of microfinance: in November 2005, Pierre Omidyar (founder of eBay) announced a $100 million microfinance fund in partnership with Tufts University for exclusive investments in the microfinance initiatives. TIAA-CREF created in September 2006 a $100 million Global Microfinance Investment Program (GMIP) to invest in selected microfinance institutions worldwide. TIAA-CREF made a $43 million private equity investment in Pro Credit Holding AG, a microfinance company. These are high profile, large-scale investment initiatives. Given the current size and status of microfinance institutions it will be interesting to see how these initiatives pan out.

4. EVOLUTION OF MICRO FINANCE IN INDIA:

As we discussed in earlier chapters microfinance operation is not a new concept in the financial transactions. There were diverse forms of finance and advancing activities existed in different parts of the world since the growth of human history. It contains individual financing, many types of chitties, and also kurikkalyanam in Malabar area of Kerala. All these original financial institutions were directed microfinance activities in one way or the other. But present types of microfinance were started from since later half of 20th century especially after 1970. Our country also saw the development of such like institutions in the similar period. Governments took some major initiative to decrease poverty by educating access to financial services to poor started since independence. India's crushing mainstream of poor is situated in rural areas and this encouraged the government to give special devotion to rural credit. Following the report of All India Rural Credit Survey in mid1950's, the government took vital steps in revising Cooperative structure including the partnership of State in cooperatives. Also the policy initiative of 'social banking' thought run to the nationalization of commercial banks, adoption of direct lending programmes to rural areas and development of credit institutions such as Regional Rural Banks (RRBs) and National Bank for Agriculture and Rural Development (NABARD) .

Non Governmental Organizations (NGOs) playing a vital role as in emerging in microfinance sectors, and as a comeback to the failure of present structures to deliver financial services to the poor. The efforts by NGOs have appeared from popular and represent diversity. They do not appropriate into a limitation.
These administrations encourage the poor to interact with the credit groups, supports to manage their savings, loan-deposit and recovery process and may also offer an interest free loan to the group that acts as a start-up fund.

The second channel is Micro Finance Institution (MFI). The MFI in India was first announced in 1974, but the momentum was achieved only during the 1990s.In the country Self Employed Women's Association (SEWA) Bank is the oldest micro Finance organization. It was founded in 1974 in Ahmadabad, Gujarat as a trade union first, started organizing self-employed women. Primarily the formal financial institutions were unenthusiastic to be involved with the MFIs, and social entrepreneurship was also in short supply. But after 1990s banks and other financial institutions, assisted by supportive public policies, have become more conscious of the commercial capability of the micro finance services. Innovative partnership models have been developed between the banks and the MFIs. These have drove enormous funds to the sector and have next enabled MFIs to increase their scale of operations and outreach.

Encouraging National Bank for Agriculture and Rural Development (NABARD) to set targets for the self-help group (SHG) – Bank linkage programme

- Emergence of SIDBI Foundation for Micro-Credit as a financier of microfinance institutions (MFIs).
- The pronouncements of the Reserve Bank of India (RBI) from time to time – such as including lending to SHGs as a part of priority sector targets exempting non-profit companies doing microfinance from registering as an NBFC permitting the establishment of local area banks (now withdrawn).
- Appointed a committee to study about regulatory measures to implement for smooth functioning of MFIs. (Melegam committee).
- Setting up of the RashtriyaMahilaKosh to re-finance microfinance activities of NGOs.

5. OBJECTIVES OF THE STUDY:

- *The main objective of the study is to identify the contribution of MFI's in improving standard of living through providing credit.*
- To identify the contribution of finance in enhancing household income in Indore.
- To identify loan purposes and income generating activities of households in the study of Indore.

6. FEATURES OF MICROFINANCE:

- It is an essential part of rural finance
- It deals in small loans.
- It basically caters to the poor households.
- It is one of the most effective and warranted Poverty Alleviation Strategies.
- It supports women participation in electronic activity.
- It provides an incentive to grab the self-employment opportunities.
- It is more service-oriented and less profit oriented.
- It is meant to assist small entrepreneur and producers.
- Poor borrowers are rarely defaulters in repayment of loans as they are simple and God-fearing.

For more elaborative characteristics and features, see figure 1.

Characteristics	Distinguishing Features
Type of client	• Low Income • Employment in informal sector; low wage bracket • Lack of physical collateral • Closely interlinked household/business activities
Lending Technology	• Prompt approval and disbursement of micro loans • Lack of extensive loan records • Collateral substitutes; group-based guarantees • Conditional access to further micro-credits • Information-intensive character-based lending linked to • cash flow analysis and group-based borrower selection
Loan Portfolio	• Highly volatile • Risk heavily dependent on portfolio management skills
Organizational Ideology	• Remote from/non-dependent on government • Cost recovery objective vs. profit maximizing
Institutional Structure	• Decentralized • Insufficient external control and regulation • Capital base is quasi-equity (grants, soft loans)

Microfinance is providing various types of services, which includes microcredit. Microcredit is facility of credit services to lower income clients. Micro credit and micro-finance both are not having the same meaning. Micro credit is a slight amount of money, given as a credit by a bank or any legally registered institution, on the other hand, Micro-finance includes several services such as loans, savings, insurance, transfer services, micro credit loans, etc. for low income people.

7. OBJECTIVES OF MICROFINANCE:

The organizations working to encourage microfinance institutions in different measures of the world describe several objectives to microfinance. The significant among them are listed as follows.

- Promote socio-economic development at the grass root level through community-based approach.
- Develop and strengthen people's groups called Self-Help Groups and facilitate sustainable development through them.
- Provide livelihood training to disadvantaged population.
- Promote activities which have community participation and sharing of responsibilities
- Promote programs for the disabled.
- Empower and mainstream women.
- Promote sustainable agriculture and ecologically sound management of natural resources.
- Organize and coordinate networking of grass root level organization.
- Get benefits by reducing expenditure and making use of local resources as inputs for livelihood activities.
- Increase the number of wage days and income at household level.

8. THE NATURE OF MICROFINANCE: MICROFINANCE VS MICROCREDIT:

In order to reduce the physical, and often cultural, gap between intermediaries who provide credit and the beneficiaries of the microcredit, many institutions have recourse to a network of local promoters, known as loan officers, who visit potential clients to gather information during the selection and monitoring phases and, later, to collect instalments for loans granted. Socio-demographic changes over the last few decades have significantly altered the world economic scene. For microfinance, the new situation has meant potential new beneficiaries, new products and a greater involvement of financial intermediaries.

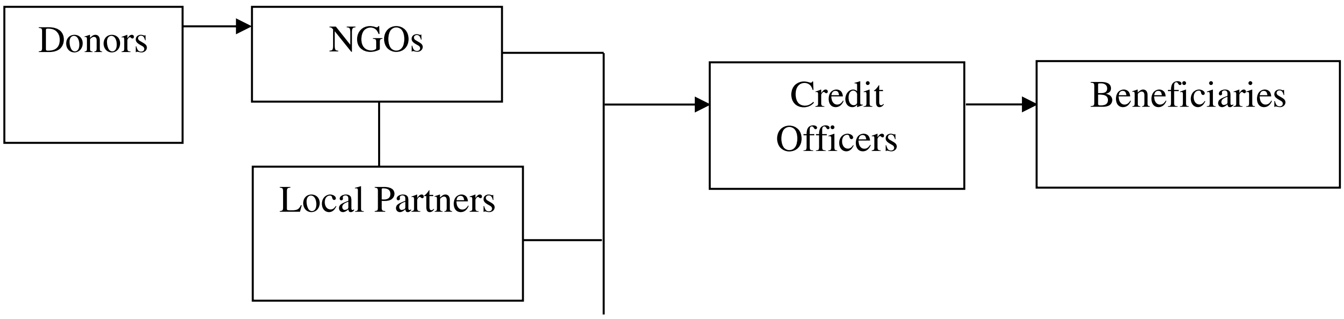

Figure 1.1
The standard microcredit structure

Exclusion from the traditional financial system, seen as the inability to access basic financial services, includes millions of people today, both in developing countries and industrialized Microfinance countries. Traditional poverty thresholds have shifted and new categories of 'poor' people have appeared, even out with developing countries. New beneficiaries have [i]brought new financial needs with them.The widening of the services on offer has taken five directions: credit products, which provide alternatives to loans, savings, insurance services, structured finance and technical assistance. It is not surprising, therefore, that in the last few years financial intermediaries in industrialized countries have been taking greater notice of microfinance. It represents a way of reaching and gaining loyalty from new groups of clients and helps to improve corporate social responsibility.

9. CONCLUSION:

Poverty levels are declining and are bound to decline further by accessing to various financial services and products. The households will have greater levels of incomes and at the same time the number of saving, entrepreneurs and financial transaction will increase. The segment will require easy access to formal financial systems to get into the banking fold. Banks require innovating and devising newer methods to absorb such customers into their fold as these new prospective customers will turn into commercially viable customers. The demand and supply side should take the initiatives.

MFI's and the self-help group is the tool to reduce the poverty in India. Though they are congregation momentum, they still require support to spread to the length and breadth of India and to penetrate to different parts of India Businesses facilitators and correspondents have grown in numbers but to achieve desired level of financial inclusion and innovations are desirable. New entrants to the banking system perhaps need 'home delivery 'or 'near home delivery' rather than stepping into the branches.

With increasing liberalization and higher economic growth, the role of the MFI's and the self-help group poised to attain greater heights in India. The banks and financial institution need to organize resources from a wider customer base and extend credit to business activities not financed by banks till now.
Increasing commercialization of agriculture and rural activities is bound to result in to cycle of improved standard of living, access to financial service and investment.

10. RECOMMENDATION:

- There is no solitary growing tool that can eliminate poverty extensively, however, microfinance can contribute to kind some improvements in poverty reduction effort.
- Government should design a policy to assist micro-finance institutions to achieve credit form the typical commercial banks to poverty.
- Microfinance programs should be require to understanding the financial needs of its potential clients and how borrowing and saving fit into their money management strategies.
- Slight attention must be paid to how people actually use financial services in relation to their financial needs.
- MFI's should be concern about the relationship between risks to the client and risks to the loan portfolio.
- Microfinance cannot be considered as a magical tool that can eliminate poverty; it only can contribute to this process and play an vital role in improving the standard of living of the poor's.

12. LIMITATIONS:

- The present study was conducted in only one regions of Madhya Pradesh.
- This study is quite perception based study, the perception may be wrong.
- The area of study is limited to Indore result may be differing from place to place.

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