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MICROFINANCE CAN REDUCE POVERTY- A DESCRIPTIVE STUDY

Anuj Jain
Research Scholar
CMJ University
Shillong, Meghalaya

Rajiv Chopra
Associate Professor
Department of Commerce
Sri Aurobindo College,Delhi

ABSTRACT

India is a developing country having low income class according to World Bank. It is second Populated country in the world and around 70 % of its population lives in rural Area. About 60% of its population depends on agriculture for its livelihood. Due to this, there is chronic Underemployment and low per capita income. Low income means low savings and consequently low investment. Ultimately the result is poverty. The major factor account for high incidence of rural poverty is the low investment and other asset base. An effective formal cum informal credit system, proper training, good saving system and efficient use of credit can help the people in rural areas to break their vicious circle of poverty. Now the question arises which effective system can do all these tasks? The answer to this question is "MICROFINANCE". Through this paper an attempt has been done analyze that role of microfinance in reduction of poverty in India.

Keywords: Microfinance, Poverty Reduction, MFIs, Customer Data Base

I. INTRODUCTION

In India more than 70% of the population lives in villages and most of these villages are underdeveloped. Research and development sector in our country brings number strategies in favour of these people every year. Implementation of these technologies in the rural sector can alleviate poverty, create employment opportunities and generate good growth. However, for implementing these technologies micro financing through public and private sector agencies is the need of the hour. Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities enable the poor to smoothen their consumption, manage their risks better, build their assets gradually and develop their micro enterprises. Government, NGOs and other financial institutions have introduced various welfare schemes and activities to reduce poverty. Microfinance, by providing small loans and savings facilities to those who are excluded from commercial financial services has been developed as a key strategy for reducing poverty throughout the world. In India, a substantial microfinance system based on self help groups (SHGs) was developed. It allows poor people to protect, diversify and increase their sources of income, the essential path out of poverty and hunger. As a developmental and economic tool it has caught the imagination of banks, financial institutions and NGOs in India.

II. OBJECTIVE OF THE STUDY

The objective of this study is to analyze the workings of MFIs in rural areas of India and to review for how long such institutions can be helpful for poor people.

III. RESEARCH METHODOLOGY

a) DATA COLLECTION

This is a descriptive research paper based on secondary data. Data have been collected through the annual reports of NABARD, websites, research paper, Journals and magazines.

IV. STRUCTURE OF MICROINANCE

a. In India microfinance operates through two channels:

1. SHG – Bank Linkage Programme (SBLP)
2. Micro Finance Institutions (MFIs)

b. Different legal forms under which MF can be provided in India

1. Commercial Banks
2. Cooperative Banks
3. Regional Rural Banks (RRBs)
4. Local Area Banks (LABs)
5. Cooperative Societies, SHGs and Federations
6. Societies
7. Trusts
8. Non-Banking Finance Companies (NBFCs)
9. Organizations under guidelines of the Reserve Bank of India

Among these, the MFIs can either take up the form of a Society, Trust, Co-operative Society, or NBFC. There is no centralized database on the number of microfinance institutions that operate in the country.

V. ROLL OF MFIs IN REDUCTION OF POVERTY

[1] SELF EMPLOYMENT

Poverty reduction through self employment has long been a high priority for the Government of India. Microfinance is an experimental tool in its overall strategies. Most of poor people manage to optimize resources over a time to develop their enterprises. Financial services could enable the poor to leverage their initiative, accelerating the process of generating incomes, assets and economic security. However, conventional finance institutions seldom lend down-market to serve the needs of low-income families and women-headed households. Therefore fundamental approach is to create the self employment by financing the rural poor through financial institutions. Microfinance, thus, creates the hope and increases the self-esteem of the poor by giving the opportunities to be employed.

[2] WOMEN EMPOWERMENT

In rural areas women living below the poverty line are unable to realize their potential. Microfinance programmes are currently being promoted as a key strategy for simultaneously addressing both poverty alleviation and women‘s empowerment. The self help group (SHGs) of women as sources of microfinance have helped them to take part in development activities. The participation of women in SHGs made a significant impact on their empowerment both in social and economic aspects. Vast sections of the rural poor are even now deprived of the basic amenities, opportunities and oppressed by social customs and practices. Several programmes were implemented by various governments and nongovernmental organizations to uplift them both economically and socially. It has been an accepted premise that women were not given enough opportunities to involve themselves in the decision making process of the family as well as in the society. Hence, women were the main target groups under SHG programme. Microfinance can provide an effective way to assist and empower poor women, who make up a significant

Proportion of the poor and suffer from poverty.

[3] POVERTY REDUCTION TOOL

Microfinance can be a critical element of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smooth their consumption, manage their risks better, build their assets gradually, and develop their micro enterprises. Microfinance is only a means and not an end. The ultimate goal is to reduce poverty. Government, NGOs and other financial institutions have introduced various welfare schemes and activities to reduce poverty. Microfinance, by providing small loans and savings facilities to those who are excluded from commercial financial services has been developed as a key strategy for reducing poverty throughout the world.

VI. TOOLS USED IN MICRO-FINANCE

a. ARRANGING FIXED DEPOSITS FOR MFIs/NGOs

Under this scheme government of India arrange money to MFI/NGO like SIDBI for micro credit to poor.

b. TRAINING AND STUDIES ON MICRO-FINANCE PROGRAMME

Government of India would help SIDBI in meeting the training needs of NGOs,SHGs, intermediaries and entrepreneurs and also in enhancing awareness about the programme.Institution building for' intermediaries' for identification of viable projects: The Government of India would help in institution building through identification and development of 'intermediary organization', which would help the NGOs/SHGs identification of product, preparation of project report, working out Forward and back ward linkages and in fixing marketing/ technology tie-ups. The SISIs would help in the identification of such intermediaries in different areas.

c. BUDGETARY PROVISION FOR THE SCHEME DURING 10th PLAN

There was a budgetary provision in 10th five year plan and hoping more funds in next plan.

d. Administrative arrangement:

A committee has been formed to control and monitor the administrative arrangement of MFI/NGOs.

VII. CHALLENGES BEFORE MFIs

Microfinance institutions have faced a lot of issues about its performance and sustainability. Microfinance institutions have been viewed as an important tool in poverty alleviation and financial inclusion. It is an important sector which would improve the living conditions of the poor and lead to the development of the country. Some of the issues faced by microfinance institutions include high interest rates, multiple lending, coercive methods of recovery, lack of transparency etc.

1) ADMINISTRATIVE DIFFICULTIES

Small rural farmers often live geographically scattered, in areas with poor communication facilities, making loan administration difficult.

2) LACK OF INFORMATION

The absences of standardized information, Standard lending tools, such as financial statements or credit histories, do not exist in these areas.

3) FINANCIAL ILLITRACY

One of the major hindrances in the growth of the microfinance sector is the financial illiteracy of the people. This makes it difficult in creating awareness of microfinance and even more difficult to serve them as microfinance clients. Though most of the microfinance institutions claim to have educational trainings and programmes for the benefit of the people, according to some of the experts the first thing these SHG and JLG members are taught is to do their own signature. The worst part is that many MFIs think that this is what financial literacy means. We all know how dangerous it can be when one doesn't know how to read but he/she knows how to accept or approve it.

4) GENERATION OF SUFFICIENT FUNDS

Inability of MFIs to raise sufficient fund remains one of the important concern in the microfinance sector. Though NBFCs are able to raise funds through private equity investments because of the for-profit motive, such MFIs are restricted from taking public deposits. Not-for-profit companies which constitute a major chunk of the MFI sector have to primarily rely on donations and grants from Government and apex institutions like NABARD and SIDBI. In absence of adequate funding from the equity market, the major source of funds for MFIs are the bank loans, which is the reason for high Debt to Equity ratio of most MFIs.. After the Andhra crisis, it is reported that banks have stopped issuing fresh loans and even though currently few banks have resumed, they want MFIs to increase their equity to get fresh loans. So the only mode for the MFIs to increase their portfolio size is to increase their equity. The problem of inadequate funds is even bigger for small and nascent MFIs as they find it very difficult to get bank loans because of their small portfolio size and so they have to look for other costlier sources of fund.

5) Migration of Group Member

Majority of the microfinance loans are disbursed on group lending concept and a past record of the group plays an important role in getting new loans either through SHG-Bank linkage or through MFIs. The two major problems with the group concept are dropouts (when one or more members leave the group) and migration (when one or more members move to another group). Most MFIs lend on the basis of the past record of the group i.e. SHG or JLG and also on the individuals repayment performance. In absence of a decent past record, members are deprived of getting bigger loan amounts and additional services.

VIII. HIGHLIGHTS OF MICRO FINANCE BILL- 2012

The Government has introduced a bill in the lok sabha to empower the reserve bank of India to regulate the micro finance Industry and fix interest rate ceiling on loans to be provided by lenders. The micro institutions (development and Regulation) bill, 2012 which was introduced in the house by finance minister Pranab Mukherjee, confers power upon the RBI to fix the maximum Interest rates that micro finance institutions (MFIs) can charge and also decide on the fair and reasonable method of loan recovery. It provides for regulation of activities such as micro credit, thrift, pension or Insurance services and remittance of funds by MFIs. The bill was drafted in the back drop of problems faced by borrowers of MFIs in Andhra Pradesh and other states, seeks compulsory registration of MFIs with the RBI. They should have minimum net owned funds of 5 lakh. RBI can inspect the accounts of the micro-lenders and impose monitory penalty for non-compliance of the provisions of the proposed legislation. MFIs would need RBI approval to close down or restructure. RBI would make provision for constitution of the micro finance development funds, would be utilized for the purpose of providing loans and seed capital to MFIs and set up of Grievance redressal mechanism. The bill also make a case for establishment of state micro finance council for considering the extend of MFIs activities in the state.

IX. RECOMMENDATIONS

X.

1. MAINTENANCE OF PROPER RECORDS

the most important tool for the success of MFI to maintain its effective customer data base in such a manner that the situation like ANDHRA CRISIS may not arise in future. These records will prevent the prospected customers to take repeated loans from different MFIs.

2. Proper Regulation

The regulation was not a major concern when the microfinance was in its nascent stage and individual institutions were free to bring in innovative operational models. However, as the sector completes almost two decades of age with a high growth trajectory, an enabling regulatory environment that protects interest of stakeholders as well as promotes growth, is needed.

3. Field Supervision

In addition to proper regulation of the microfinance sector, field visits can be adopted as a medium for monitoring the conditions on ground and initiating corrective action if needed. This will keep a check on the performance of ground staff of various MFIs and their recovery practices. This will also encourage MFIs to abide by proper code of conduct and work more efficiently. However, the problem of feasibility and cost involved in physical monitoring of this vast sector remains an issue in this regard.

4. ENCOURAGE RURAL PENETRATION

It has been seen that in lieu of reducing the initial cost, MFIs are opening their branches in places which already have a few MFIs operating. Encouraging MFIs for opening new branches in areas of low microfinance penetration by providing financial assistance will increase the outreach of the microfinance in the state and check multiple lending. This will also increase rural penetration of microfinance in the state.

MFIs should provide complete range of products including credit, savings, remittance, financial advice and also non-financial services like training and support. As MFIs are acting as a substitute to banks in areas where people don’t have access to banks, providing a complete range of products will enable the poor to avail all services.

5. TRANSPARENCY OF INTEREST RATES

As it has been observed that, MFIs are employing different patterns of charging interest rates and a few are also charging additional charges and interest free deposits (a part of the loan amount is kept as deposit on which no interest is paid). All this make the pricing very confusing and hence the borrower feels incompetent in terms of bargaining power. So a common practice for charging interest should be followed by all MFIs so that it makes the sector more competitive and the beneficiary gets the freedom to compare different financial products before buying.

6. TECHNOLOGY TO REDUCE OPERATING COST

MFIs should use new technologies and IT tools & applications to reduce their operating costs. Though most NBFCs are adopting such cost cutting measures, which is clearly evident from the low cost per unit money lent (9%-10%) of such institutions. NGOs and Section 25 companies are having a very high value of cost per unit money lent i.e. 15-35 percent and hence such institutions should be encouraged to adopt cost-cutting measures to reduce their operating costs. Also initiatives like development of common MIS and other software for all MFIs can be taken to make the operation more transparent and efficient.

7. ALTERNATIVE SOURCES OF FUND

In absence of adequate funds the growth and the reach of MFIs become restricted and to overcome this problem MFIs should look for other sources for funding their loan portfolio. most of the microfinance institutions are converting into NBFC MFIs in order to have easy access to funds from banks. This transformation is due to the profit motive of the microfinance institutions. The microfinance institutions should be given the access to raise funds from capital markets providing they are well rating in their performance. Some of the ways through which MFIs can raise their fund are:

8. BY GETTING CONVERTED TO FOR-PROFIT COMPANY I.E. NBFC

Without investment by outside investors, MFIs are limited to what they can borrow to a multiple of total profits and equity investment. To increase their borrowings further, MFIs need to raise their Equity through outside investors. The first and the most crucial step to receive equity investment are getting converted to for-profit NBFC. Along with the change in status the MFI should also develop strong board, a quality management information system (MIS) and obtain a credit rating to attract potential investors.

9. PORTFOLIO BUYOUT

It is when banks or other institutions purchase the rights to future payment stream from a set of outstanding loans granted by MFIs. In such transactions MFIs are responsible for making up any loss in repayment up to a certain percentage of the portfolio and this clause is known as "first loss default guarantee". The above clause ensures that the MFI retains the correct incentive to collect these loans. To ensure security to the buying institution, MFIs are allowed to sell off as much of the outstanding portfolio as is financed by accumulated earnings or equity.

10. SUFFICIENT REPAYMENT TIME

Most of the micro-loans are given for the start of micro-enterprises and the loan would have to be repaid from the cash flows generated from the business. Hence, sufficient repayment time should be given by the microfinance institutions to the borrowers.

11. REGULAR AUDITS

Regular audits such as ACCION audit could be conducted by the regulatory authority to monitor the performance of MFIs. Subsidies could be provided for these audits as most of the MFIs do not undergo this audit as it is expensive.

XI. CONCLUSIONS

Rural development and poverty reduction are commonly related to the issue of rural employment. Rural households livelihood strategies comprise several options, including farming and non-farm activities, local self-employment and wage employment, and migration. Microfinance has proven to be an effective and powerful tool for rural development and poverty reduction. Like many other development tools, it has sufficiently penetrated the poorer strata of society. The poorest form the vast majority of those without access to primary health care and basic education; similarly, they are the majority of those without access to microfinance. Micro-finance is one of the ways of building the capacities of the poor and devloping them to self-employment activities by providing financial services like credit, savings and insurance. To provide micro-finance and other support services, MFIs should be able to sustain themselves for a long period. There are so many schemes for the development of poor In India. Creating self employment opportunities through micro finance is one way of attacking poverty and solving the problems of unemployment. In India, the micro finance movement has almost assumed the shape of an industry, embracing thousands of NGOs/MFIs. During the last decade, the sector has witnessed a sharp growth with the emergence of a number of Micro Finance Institutions (MFIs) providing financial and non-financial supports to the poor in an effort to lift them out of poverty. There are over 1,000 Indian MFIs. These institutions assume the responsibility of making available much needed micro credit to the poor section of the society for generating the self employment The MFI channel of credit delivery, coupled with the national level programme of SHG-Bank Linkage, today, reaches out to millions of poor across the country.

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