Microfinance Programmes and its effect to reduce poverty in India

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Abstract

The paper looks at the growth and transformation of microfinance institution in India with different features in providing services. The structure of microfinance institutions has been discussed and in order to penetrate into the poverty and downtrodden segment for their alleviation. Micro finance is an emerging reality in contemporary development discourse and has come to occupy a significant place in financial intermediation in India. Micro-finance, 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. This working paper examines the evolution of the Microfinance revolution in India as a powerful tool for poverty alleviation. Recent events in India have brought a fresh focus upon the problem of regulation in the field of micro finance. The paper argues for mainstreaming impact assessment in evaluation of programs of micro finance for realizing the full potential in achievement of Millennium Development Goals (MDGs) and also to explore the positive and the other side of micro finance programs running in India.

Key Words: Micro finance , Poverty Alleviation, Microfinance institutions, MDGs.

INTRODUCTION

"Microfinance recognizes that poor people are remarkable reservoirs of energy and knowledge. And while the lack of financial services is a sign of poverty, today it is also understood as an untapped opportunity to create markets, bring people in from the margins and give them the tools with which to help themselves."

Kofi Annan

Former UN Secretary General

The 1.15 billion Indian populations comprises approximately one sixth of the world's population. Among this, ten percent of the population possesses a large proportion of the total wealth of India. Interestingly, four Indians were ranked within the top ten of the world's billionaires list in March 2008. This shows that a wide gap exists between the rich and the poor in India. Microfinance has become a buzzword of the decade, raising the provocative notion that even philanthropy aimed at alleviating poverty can be profitable to institutional and individual investors. 'Microfinance refers to small scale financial services for both credits and deposits- that are provided to people who farm or fish or herd; operate small or micro enterprise where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries in both rural and urban areas'- Marguerite S. Robinson.

The Indian state put stress on providing financial services to the poor and underprivileged since independence. The commercial banks were nationalized in 1969 and were directed to lend 40% of their loan able funds, at a concessional rate, to the priority sector. The priority sector included agriculture and other rural activities and the weaker strata of society in general. The aim was to provide resources to help the poor to attain self sufficiency. They had neither resources nor employment opportunities to be financially independent, let alone meet the minimal consumption needs. This revolutionary and pro-poor economic activity has been recognized worldwide as an efficient tool to combat poverty, create jobs and generate income. Government, NGOs and other financial institutions have introduced various welfare schemes and activities to reduce poverty. Above all, it has been regarded as a tool of financial inclusion – that is, including masses in the progress of mankind. During the past few years, India has demonstrated a welcome willingness to innovate and to think afresh about financial services to alleviate poverty. In the late eighties, microfinance emerged on the scene as a model to accelerate the process of extending banking services to the poor. This paper provides a quick view of the scenario of micro credit in India. This Paper will focus on two specific questions:

- What is the evidence for the effects of microfinance on poverty reduction as defined by the Millennium Goals?
- Are the effects different depending on the degree of poverty?

There is a question mark on the viability of the Microfinance Institutions. Given the massive growth in micro credit in recent years, the explosion of micro credit dispensing institutions, and the application of risk transfer devices such as securitization to micro credit, it is inevitable that there is some structured thinking on the institutional framework for micro credit. A comprehensive planning is something that is needed at a proper time – when the instrument is too mature to need pampering, and too immature to deserve total freedom. Micro credit is the extension of very small loans (micro loans) to those in poverty designed to spur entrepreneurship. These individuals lack collateral, steady employment and a verifiable credit history and therefore cannot meet even the most minimal qualifications to gain access to traditional credit. Micro credit is a part of microfinance, which is the provision of a wider range of financial services to the very poor. As per RBI Master Circular, 2008 Micro Credit is defined as provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards. Micro Credit Institutions are those, which provide these facilities.. Evidently, the word micro credit does not have an exact definition. For regulatory purposes, non-banking financial institutions enjoy exemption from the RBI Regulations if such institutions provide loans upto Rs 50000/-, and in case of loan for a dwelling unit, upto Rs 125000/- (NOTIFICATION No. DNBS.138/CGM(VSNM)-2000 dated January 13, 2000). The concept of micro credit is known more by its approach than by monetary limits to the amount of loans. Of course, the target segment is the poorest, with a special emphasis on the concept of joint-liability or peer-pressure, as propagated by Muhammad Yunus , founder of the Grameen Bank, which is generally considered the first modern microcredit institution, founded in 1976. Most micro credit loans are dispensed through village or community-level self-help groups (SHGs) who agree to create a pressure on the individual borrower to perform as per contract.

MICROCREDIT : Scenario in India

Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women's Association ("SEWA") of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganized sector in Ahmadabad City, Gujarat. The microfinance sector went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. From humble beginnings, the sector has grown significantly over the years to become a multi-billion dollar industry, with bodies such as the Small Industries Development Bank of India and the National Bank for Agriculture and Rural Development devoting significant financial resources to microfinance. Today, the top five private sector MFIs reach more than 20 million clients in nearly every state in India and many Indian MFIs have been recognized as global leaders in the industry. According to recent RBI estimates, there are over 450 million "unbanked people" in India, most of who live in rural areas. The term "unbanked" refers to people who have no access to formal financial services, but rather must rely on either family, or informal providers of finance, such as the village moneylender. It is undisputed that access to finance is critical for enabling individuals and communities to climb out of poverty. Microfinance in India is currently being provided by three sectors: the government, the private sector and charities. These three sectors, as large as they are, have only a small fraction of the capital and geographic scale required to meet the overwhelming need for finance amongst India's rural poor.

Microfinance evolved in India in the early 1980s with the formation of informal Self Help Group (SHG) for providing access to financial services to the needy people. The MFIs are organized under three models: SHGs, Grameen model/Joint liability groups and Individual banking groups as in cooperatives. Over the past few decades, this innovative scheme has attracted a range of nongovernmental and state-sponsored institutions. Leading financial institutions are the Small Industries Development Bank of India (SIDBI), the National Bank for Agriculture and Rural Development (NABARD) and the Rashtriya Mahila Kosh (RMK). Afew NGOs like PRADAN, ICECD, MYRADA, SEWAhave played a significant role in promoting micro-credit.With micro-credit becoming financially viable, even commercial banks like ICICI Bank, ABNAMRO, HDFC Bank, UTI Bank and international banks like Citibank have also entered the field. Non-banking corporates are participating as well. Microfinance in India through its major channels served over 33 million Indians in the financial year 2007-08, up by 9 million over the last financial year, out of which around 80% clients were women. As on 31st March, 2008, outstanding microcredit portfolio of India Microfinance was about Rs. 22,000 crore, out of which 75% are accounted for by SHG- Bank Linkage Program, 20% by large MFIs and 5% by medium and small MFIs. India's MFIs operate in 209 out of 331 poorest districts of the country; up by 5% over the previous year. The Table below gives the volumes of MFIs, that is, excludes the volume of SFG-Bank linkage program.

Status of Microfinance in Indian States:-

Indian States have the dynamism of a new state eager to exploit its resources and potential to attract investments in it areas of comparative and competitive advantage. The key elements of the industrial and infrastructure development policies favors microfinance led development as:

- The states wants to promote industrialisation both in the organised and small-scale sector, particularly those with backward linkages to agriculture and forest resources. The aim is to strike a balance with the large pool of forest resources. lFinally, the objective is to exploit its proximity to the National Capital Region (the large urban and industrial cluster around New Delhi) to market.
- The states aims to promote leading edge technologies and sunrise industries in the State in the areas of Information Technology and Biotechnology.
- Public/private sector involvement in generation of power and strengthening of the transmission and distribution network will be encouraged in the state.
- To develop some states as a premier education and research centre by leveraging the presence of world-class Research and Technical Institutes existing in India.

India is one of the few countries in the developing world that has followed the model of creditled rural development and poverty alleviation, inspired by the success of the German and Dutch rural credit systems evolved 200 years ago under the Raiffeisen model. Credit Cooperatives were first tried and when found inadequate to meet the challenge, Commercial Banks were roped in and later Rural Banks created for focused attention to rural credit. That even today, about 70% of Indians in rural areas do not possess even the basic savings bank account speaks of the distance yet to be covered.

In the late eighties, microfinance emerged on the scene as a model to accelerate the process of extending banking services to the poor. The issue is whether microfinance is the magic bullet that has the ability to alleviate widespread poverty and "make poverty history", as famously stated by Nobel Prize Winner Mohammed Yunus of Bangladesh Grameen Bank. Let us look at the issue on balance.

The positives:

Some of the established empirical evidences from over two decades of studying the Indian microfinance sector is that:

- Microfinance have certainly helped the poor manage their cashflow cycles better, especially considering the seasonal nature of agricultural income. This easy and convenient access to small ticket loans has eased dependence on the high cost informal sources.
- Another clear indicator is the improvement in health and nutritional status as also school attendance by children of those covered by microfinance programmes. These are important achievements because, as the structure of our economy is changing, educational attainment will be important for participation in the economy, and, among the poor in India, a full 30% of those who enter hospitals plunge below the poverty line from the burden of medical bills due to the low preventive medicare and absence of public services.
- There has also been positive impact through collective action and social mobilization and has provided a voice to the marginalized sections of society.
- One of the key achievements of and possibly the biggest strengths of the Indian microfinance programme has been inculcating thrift and saving habit among the poor.

The other side:

It is seen that even in nations that have a longer history of microfinance programmes than India (such as Bangladesh), the levels of poverty continue to be high, inspite of a majority of the poor being under the umbrella of microfinance.

- The most vulnerable and ultra poor get excluded from conventional microfinance programmes. Leading Microfinance Institutions like BRAC and ASA of Bangladesh have therefore, designed specific programmes for ultra poor/ hardcore poor, which blends nutrition and skill development with microfinance.
- In the Indian context, microfinance programmes have become an excuse for governments to abdicate their role in providing social security to the vulnerable population.
- The preoccupation with microfinance by government agencies has led to neglect of social safety net programmes. The insistence of routing welfare programmes through the self-help group has had the

effect of exclusion of those not members of groups, even if they merit coverage. Further, some government agencies are transferring tasks that they should be doing to self-help groups without adequate compensation or the corresponding shrinkage of the department.

➢ Bankers have also found microfinance as a convenient excuse to deny provision of small loans directly to individuals suggesting them to approach the bank in a group mode. Further, the frequent rotation of officers in rural branches of commercial banks (on completion of the minimum rural tenure) has led to discontinuity and uneven quality of the programme.

➢ In countries like Kenya, when the civil society organizations diverted their attention to microfinance, even if as an add on to their other programmes, it impacted implementation of the other welfare programmes and resulted in an increase in HIV prevalence, as NGOs developed greater interest in implementing microfinance programmes.

➢ The promised graduation of microfinance clients to micro enterprises has also not materialized even after all these years. Infact, research scholars in this sector

have shown that beyond a threshold level of Rs. 50,000 per individual, microfinance borrowers tend to face serious difficulties and in some cases fell back into a situation worse off than what they were prior to enrolling as microfinance clients. Overall, therefore, it can be concluded that microfinance itself is a starting point for providing access to financial services to those who are at present excluded. It does not offer a long term and sustainable solution to the multidimensional aspects of the poverty, unless blended with various other support systems including education, health care, social security and equal opportunity. Let us remember the words of Jesus which I have quoted, that the poor will always be there and poverty alleviation will have to be a continuing endeavor. Simanowitz & Walter (2002, p3) correctly observe that "Microfinance is a compromise between social and financial objectives. To date most emphasis has been on financial and institutional performance". In order to bring the social aspect back into microfinance, Imp-Act42 based on three years of action research covering 30 organisations in 20 countries has been advocating mainstreaming of Social Performance Management (SPM) to improve the effectiveness of microfinance in reducing financial exclusion and poverty. While microfinance may be a winning proposition for banks, the winning evidence on client's side seems doubtful. The institutional approach flowing out of past negative experiences has shifted the goalpost to financial solvency but in the process missed the vital link of credit usage. In this scenario, it can be said with certainty that potential of microfinance to contribute to achievement of MDGs in India, especially reduction of poverty remains suspect. Greeley (2005)43 rightly notes that in absence of specific poverty targeting and mainstreaming of impact assessment, the claims about the impact of microfinance on the achievement of MDG lacks credibility.

Road Ahead

Indian rural finance sector is at crossroads today. Following the financial sector reforms with its emphasis on profitability as the key performance benchmark, banks are increasingly shying away from rural lending as well as rationalizing their branch network in rural areas. Burgess & Pande (ibid) have brought out this fact in their study by stating that while between 1977 and 1990 (pre reform period) more bank branches were opened in financially less developed areas, the pattern was reversed in post reform period. Thus while, access of credit to the rural poor has reduced in post reform period, the policy recommendation is to fill this gap through micro credit. The SHG-Bank linkage programme has witnessed phenomenal growth and the current strategy is to focus on 13 underdeveloped states as also graduate the existing SHGs to the next stage of micro enterprises.

At this stage, the paper argues that if SHG-Bank linkage programme has to contribute to poverty reduction, there is an imperative need for integrating impact assessment as a necessary design feature of the programme. The significance of bringing the focus back to 'people' from 'institutions' and adoption of localized people centric approach can hardly be overemphasized. In line with the tenets of commercial microfinance, it is critical that scarce public resources are used judiciously and with better targeting. Adequate emphasis on impact assessment is an integral part of the triangle44 of factors necessary for judging microfinance intervention. Mainstreaming of impact assessment in the SHG-Bank linkage programme will call for extra efforts and resources as also create conflict with the present focus on numerical growth. Realisation of a substantial trade off between sustainable economic impact and exponential growth, calls for courageous public policy decisions. World Bank policy research working paper (ibid) also points that ensuring preoccupation with achievement of numeric targets does not override attention to group quality will be a key future concern for SHG-Bank linkage programme.

Conclusion

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 205046 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. 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 micro finance 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 on achievement of MDGs and not letting go this opportunity. So far the micro credit programmes through self help groups (SHGs) have evoked mixed reactions and responses. There are two divergent views: One being the ardent supporters of the programme who celebrate the victory of micro credit programme. On the other side are the trenchant critics who fail to see anything positive in the programme. While making a conclusion one has to exercise caution. There are very few balanced impact studies done on this programme; the available micro level studies are inadequate to come to a conclusion. Hence it is not fair to generalize. Nevertheless, it is safe to conclude that there are changes, especially in the rural areas where women are more visible and mobile. Only a thorough study based on the baseline data and the present situation can tell us how far the micro credit programme has succeeded in alleviating poverty. This is not to deny the potential that the programme has to achieve this end.

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