

Microcredit for Development of Micro Enterprises Problems and Prospects

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ABSTRACT

In Labor abundant and capital short economies like India, there is a severe budgetary constraint for funds and pressing need for higher investment in the frontiers of social development. Micro Enterprises are playing a dominant role in fighting the unemployment problem Hence the people have to come forward to engage themselves in productive activities by starting their own ventures and utilize the local resources. The GDP and in turn the economic development depends on the utilization of physical natural resources by the human resource. The financial institutions envisage through Micro Finance the micro enterprises can be generated from which the desired economic development and social inclusion can be achieved The paper on “Micro Finance for Economic Development” touches upon the importance of micro enterprises in the various economies. How the Micro Finance is supporting for the development in the Middle East and North Africa (MENA), the most successful BRAC model of Bangladesh. How the micro credit from the Micro Financial Institutions from the fast developing country like China by referring Qinghai Community Development Project (QCDP) are effective for the growth of Micro Enterprises and in turn Economic Development

The paper highlighted the historical forms of Micro Finance in the countries like Bolivia, Nigeria,, Ghana, West Africa, China, Indonesia and Philippines and compared with the present scenario. It has specifically reviewed the Indian Micro Finance programs of NABARD and other NGO’s like SEWA Ahmadabad, CDS Madurai etc.The study has also thrown light on cost-effectiveness and financial sustainability in the functioning of Micro Finance Institution. The paper also focused on research results on the

operational issues like Operating Self Sufficiency (OSS) and Institutional Financial Sustainability of Micro Finance Institutions of different countries

Key Words: Sustainability, cost-effectiveness, Micro Enterprises, operating self sufficiency (oss)

1 . Introduction:

In the ongoing era of globalization which is characterized by fast changes in development and strategies, small scale industrial units have got numerous opportunities and also several challenges and threats. This is more so in respect of micro enterprises, the lowest strata among the MSMEs, as they are more vulnerable to threats in the market like competition from products from abroad. It is widely recognized that small scale enterprises can play a catalytic role in the process of development of modern economies by accelerating the pace of development and that too in an equitable, balanced and largely sustainable manner. Unfortunately, in the Indian context the indicators of economic development point to the fact that small scale sector has to catch up a lot. However, competition and such other developments induced by globalization have been inspiring small scale enterprises to go for continuously innovate their systems and process often by adopting the latest technologies.

In respect of India in particular, the peculiar capability of small enterprises in bringing about faster economic development was acknowledged relatively well even during the early years of the Plan era, despite the fact that The Industrial Policy Resolution 1956 favored priority to heavy industry. SSEs are often referred to within the broader frame- work of Small- and Medium-scale Enterprises (or, SMEs in short). SMEs play a vital and strategic role in socio-economic growth of any nation, and balanced and equitable distribution of the national resources. It is estimated that SMEs ‘constitute as high as 90 percent of enterprises in most countries worldwide, they are the driving force behind a number of innovations and contribute to the growth of the national economy through employment creation, investments and

exports' (Government of India Report, 2007). The contribution of SMEs toward poverty reduction and wider distribution of wealth in the developing economies need not be overemphasized. Since the enactment of Micro, Small and Medium Enterprises Development Act 2006 (MSMED Act 2006) SSEs, SMEs etc. are often referred to under the common term Micro, Small and Medium Enterprises (or, MSMEs in short). The MSMED Act 2006 came into effect on October 2, 2006. MSMED Act 2006 classifies MSMEs into three types (Table I). Of the three types of MSMEs, the lowest strata viz. micro enterprises require the lowest level of investment. They are the most affordable for new entrepreneurs, women, rural poor etc. They have huge potential for equitable and balanced development for a nation like India. This paper focuses on micro enterprises.

2. Objectives and Methodology

This paper seeks to look into the strategic role that micro enterprises perform in ensuring balanced and equitable development in India through review of literature. The sources of data are primarily secondary, comprising of publications and reports of Government India, Government of Telangana Reserve Bank of India, etc.

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Review of literature

In labor abundant and capital short economy like India there is a severe budgetary constraint for funds and the pressing need for higher investment in the frontiers of social development. Hence the people have to come forward to engage themselves in productive activities by starting their own industrial or business ventures rather than depending on some employer for employment and livelihood when more and more persons come forward to state their own enterprises small it may be and run the enterprise efficiently the productivity of the nation automatically improves as the process of economic development involves improvement in

the Gross National product and depends on the utilization of physical natural resources by the human resource to realize the productive potential of the nation It requires increase in production and consumption.

Revitalization of the agrarian economy and the rural society has a Major plank in the economic planning ever since the country embarked on planned development. However the success achieved in this regard until recently is not in tune with gigantic size of the problem. The task of rural development is a stupendous one. apart from the fact that India being the second largest country in terms of population and as more than 75 percent of India's population live in its six lakh villages and half of them are still in abject poverty Under those circumstances it is unrealistic to hope to achieve all round economic development in the country unless attempts are made to improve the living conditions of the rural poor.

Prof D.T.Lakadawala in his presidential address at the 11th Indian Labor Economic development in the Conference aptly observed that "Discussion about economic development in aggregate terms have limited relevance as against more relevant view point of reduction of unemployment or reduction in number and percentage of people below poverty line which indicates economic welfare of the people".

In India, capital is scarce while capital is scarce, the optimum use of available capital resources in terms of employment and productivity must therefore become one of the main goals of economic planning. Large industries require huge amounts of capital and their gestation period is long. If we invest the scarce capital in MSME sector the returns are quick and hence the generated returns may again form capital. MSME can thereby save, for production purposes, capital expenditure. Therefore, as MSME need less capital, yield quick returns with less risk, investment in these is preferable in India, a country where capital is relatively scarce.

According to the latest research done by the World Bank, India is home to almost one third of world's poor. Though many central government

and state government poverty alleviation programs are currently active in India. Micro Finance plays a major contributor to financial inclusion. In Bangladesh Micro credit model of Mohammed younus's Grameen Bank has proved to be very successful every year 5 percent of people are coming out of poverty with the participation of Micro Finance schemes of Grameen Bank. It was also revealed that the micro credit was useful to the participant in increasing (a) Per capita expenditure (b) Net worth (c) Children schooling and at village level, borrowing had a positive impact on (a) Production (b) Income (c) Employment (d) Wages (e) School enrollment (f)Fertility.

India, there is a wide disparity in wealth and income of people One of the important objects of planning is the reduction of inequalities. it is possible to reduce these inequalities, to some extent, by providing opportunities to have-nots to take up cottage or micro enterprise for their living .V.K.R.V.Rao has said that the a micro enterprise and cottage industries have this in their favor that , with proper safeguards they will result in a large and more widely distribution sharing of the production function and therefore , a more equitable distribution of the produce of industry further micro enterprise apart from playing a dominant part in our economy serve as a means by which there can be an equitable distribution of national wealth.

Among the different types of industry the heavy industries, due to high automation and other reasons are unable to generate more number of employment opportunities whereas the microenterprise will generate more opportunities to unemployed youth by not only self but also wage employment. According to study by SIDO a lakh of investment in fixed assets in microenterprise sector can employ four members Hence the Government have no other alternative for alleviation of unemployment and eradication of poverty .In the present age of Modernization, Globalization and Privatization the microenterprises can be developed only under the protective umbrella of the Government. Historically a large part of the policy frame work for small and microenterprises has been promotion based like reservation of products to small sector lower interests on loans and subsidies. In spite of

all the efforts the Indian microenterprise sector suffered the lack of growth and development .The developing Asian countries realized the importance of microenterprises formulated the policies and implemented effectively and enjoying the fruits. The developed countries like U.S.A and Brittan have adopted the policies on microenterprises in their countries in due recognition of success of microenterprises in developing countries. Japan the home of microenterprises. Japan is an outstanding example of those countries which have achieved rapid industrialization and development through the microenterprises The London economist observed commenting on industrial productivity "The Japanese work more entrepreneurs in small teams components flow into many tinny mini firms which operate under the big factory s financial umbrella along the automated production line , the factory's permanent workers in teams of six or seven are responsible for jointly checking each product as it passes their station, at the end of the line the completed product may be backed by a separate 5-10 employee Micro Enterprises "

Small- and micro-sized enterprises are a vital even dominant component of mostMENA economies

In Egypt, for example, small- and micro-sized enterprises provide an estimated 80% of private-sector value-added, employ two-thirds of the entire labor force, and constitute 99.7% of the total number of non-agricultural private enterprises (Ministry of Economy [Egypt] 1998). Statistics on the small- and micro-sized enterprises sector in other countries are less reliable, but in Jordan the "informal" sector is believed to employ 35% of the work force, and in Yemen 45% of it (ERF 1998). Similar ratios are likely to hold true in Morocco and Lebanon, with slightly lower levels for Algeria, Syria, and Tunisia. In spite of this obvious importance, small- and micro-sized enterprises confront a range of obstacles to growth, as well as numerous handicaps to improving competitiveness in the rapidly Globalizing world marketplace. Access to credit is one problem. In Egypt, 94% of industrial Credit is directed to the 2% of enterprises with over 50 employees and despite the existence of some 40 micro-credit programs in the country, 95% of potential beneficiaries have not reached. Micro-credit experts in Morocco believe there are as many as

1.5 million potential clients for their services, which currently reach less than 20 000 customers.

Importance of Microenterprises

The small scale industrial (SSI) registered a high growth rate since independence in spite of stiff competition from the large scale sector and a not-so-encouraging support from the government. Thus, the number of registered SSI units went up from 16,000 units in 1950 to 36,000 units

In 1961 and to 33.7 lakh units in 2001. This sector has been contributing significantly towards meeting the social objectives like providing employment to the millions of people across the country, ensuring income equality and balanced regional development, and creation of a strong entrepreneurial base. The output of this sector was Rs.1, 22,154 crore in 1995 and this went up to Rs.4, 18,263 Crore in 2005 (at current prices). Production in SSI sector during the last 10 years has recorded an annual average growth rate of 8.6 percent. The share of SSIs in the country's industrial output was nearly 39 percent as of 2005. This sector plays a crucial role in India's industrial and economic development.

. It is estimated that an investment of Rs.1.00 lakh, in fixed assets, in a large industry may create, on an average, employment to 2-4 persons whereas the same amount of investment made in a small-scale industry, for the same purpose, might do so for 10-12 persons (Government of Meghalaya, 1993). As per the MSME Act 2006, the size and scale of India's small scale sector ranges from 7.8 million to 13 million in number and the share in GDP of these enterprises is estimated to be over 80 percent. Besides, it is estimated that more than 90 percent of the

Total numbers of enterprises are coming under the category of micro enterprises (Government of India Report, 2007). This sector is quite dynamic in functioning, and acts as a nursery for promoting entrepreneurial talent and as a catalyst for industrial growth. This sector contributes significantly to the manufacturing output, employment and exports of the country. It is estimated that in terms of value, the sector accounts for about 45 per cent of the manufacturing output and 40 per cent of the total exports of the country. The sector is estimated to employ about 595 lakh persons in over 261 lakh enterprises throughout the country. This sector has consistently registered a higher growth rate than the rest of the industrial sector. There are over

6000 products ranging from traditional to high-tech items, which are being manufactured by the MSMEs in India. MSMEs provide good opportunities for both self-employment and wage employment. There are a wide range of products, of more than 6000 in number, that are produced by the MSMEs. These range from food products, wearing apparels, fabricated metal products, textiles, furniture etc.

Financial Support to Microenterprises

The program for the development of Micro Enterprise and Small Industries has been accorded a high place in India. Ever since the days of Gandhi the small industry movement had been largely regarded as a vehicle for uplifting the weaker sections of the population by providing self-employment and After independence when the problem of regional imbalances began to appear, small scale cottage and micro enterprises sector was considered as the natural vehicle for redressing such imbalances more recently when the problem of unemployment has begun to take an acute form, the ability of micro enterprises to provide jobs at a comparatively lower cost became an attractive proposition for the planner and administration. Hence the micro enterprises assumed importance in plans and policies. The implementing procedures of the existing Small Scale Industries are refined when the Small Scale Industries preceded the Micro Enterprises as a part of strategy of Government to distribute the scarce capital to more number of first generation entrepreneurs and to have more accountability in the form of return on loans. Promotional schemes for Micro Enterprises so far as the Govt. of India's policies and schemes in respect of Micro Enterprises are concerned enough. The banking and developmental institutional set up in our country is perhaps the largest in the world and well-knit with over 63000 branches of banks operating in the country apart from state level corporations with their own micro credit schemes for almost every segment of society

Micro credit has been hailed as “One of the most significant innovations in development policy of the past twenty five years”. If we examine whether Micro credit can bring an underdeveloped economy to full development, the key to micro credit’s long run effects is the “Graduation rate” that is the rate at which the self-employed build up enough wealth to graduate in to the entrepreneurial class. Kamal (1991) noted “That the higher rates of per capita income among Micro credit program borrowers compared to those who did not borrow”. Choudhary et al. (1991) “Asserted that women (and men) participating in BRAC sponsored activities have more income (both in terms of amount and source) own more often gainfully employed than non-participants”

Cost effectiveness

Cost and prospects for sustainability. An advantage of microfinance is that donor investment is recycled and reused (Wright 2000). Direct comparisons done by Khandker (1998) show that microfinance can be a more cost-effective developmental tool than alternatives including formal rural financial intermediation, targeted rural infrastructure development projects. Moreover, unlike many other interventions, Microfinance compares favorably to other interventions particularly with regard to cost-effectiveness food interventions, and rural infrastructure development projects. Moreover, unlike many other interventions, costs for microfinance tend to diminish with the scale of outreach (Rhyne 1997; Christen et al 1996)

Sustainability

Few, if any, other development tools have the potential to become sustainable such that, after initial start-up grants, new inputs are not required for every future client. There need not be a trade-off between reaching the poorest and attaining financial sustainability. Although there are no rigorous econometric models to substantiate it, there is ample evidence that MFIs targeting the poorest can fare as well financially as those that don’t (Gibbons and Meehan 2000; Churchill 2000) There is also ample anecdotal evidence that MFIs that target poorer clients can achieve substantially higher repayment rates than those that target richer clients (Pro Mujer vs. BancoSol; Grameen/BRAC vs. traditional banking system in Bangladesh) It should be noted that emphasizing financial sustainability above all else can have the practical effect of excluding the poorest because of the widespread misperception that the poorest are a greater credit risk and the reality that the unit

costs of small loans tend to exceed the unit costs of larger loans.

In developing countries, financing to the rural poor through formal financial services failed to meet the credit requirements of the rural poor people. The main reason of failure was absence of any recognized employment and hence absence of collateral with the poor. The high risk and the high transaction costs of banks associated with small loans and savings deposits are other factors which make them non-bankable. The lack of loans from formal institutions leaves the poor with no other option but to borrow money from local money-lenders on huge interest rates. In different countries including India, efforts have been made by their governments to deliver formal credit to rural areas by setting up special agricultural banks/rural banks or directing commercial banks to provide loans to rural borrowers. Financial assistance schemes for micro enterprises have liberal features like reduced promoters contribution and training and escort service support. The smaller among the small entrepreneurs always been a preferred category “Microcredit allows the poor household to take advantage of opportunities, that is, to assume risks it could not otherwise take, in order to obtain higher returns” (Dunn et al, 1996). However, these programs have also not worked well due to various reasons. The common reasons found by many researchers are the political difficulty for governments to enforce loan repayment and the selection of relatively wealthy and influential people, rather than the poor, for bank loans (Adams et al., 1984; Adams and Vogel, 1986; World Bank, 1989). Women’s World Banking (1995) estimated that in most developing countries, the formal financial system reaches to only top 25 per cent of the economically active population. This leaves the bottom 75 per cent without access to financial services apart from those provided by money-lenders and family. Thus, the inability of formal credit institutions to deal with the credit requirements of poor effectively has led to emergence of microfinance as an alternative credit system for the poor.

Microfinance scheme provides a wide range of financial services to people who have little or nothing in the way of traditional collateral. It helps them to build up assets, survive crises and to establish small business to come out of poverty. Except extending small loans (micro-credit), microfinance program provides various other financial and non-financial services such as savings, insurance, guidance, skill development

training, capacity building and motivation to start income generating activities to enhance the productivity of credit. This innovative program is reaching the poor people especially women and has an impact on their socio-economic development as well as their empowerment. This program is becoming popular and emerging as a powerful instrument for poverty alleviation in many countries of Asia, Africa, Europe and America.

Qinghai Community Development Project (QCDP), China

The program provides microfinance services to extremely poor households. "The program now has over 50,000 members and is growing strongly with a delinquency rate of about 4%. Nearly everyone takes the most flexible option, i.e., a loan in which the principal does not have to be returned until the end of the loan term. Interestingly, most clients repay before their loans fall due."

Since 1993, UNICEF (1996b) has supported a number of microcredit schemes in poorer regions of Lower Egypt and in some urban slum areas. In Alexandria, a microcredit scheme run by a local NGO combines credit for women with efforts to combat child labor. Each borrower group comprises five women, two of whom have working children. The condition for the women's loans is that all the children should go to school. This scheme, in an area with adequate access to basic education, showed that microcredit could reduce child labor and improve school attendance while at the same time improving the income levels of the participating families. It also showed that parents are willing to send their children to school once the economic condition of the family improves.

The concept of providing financial services to low income people is very old. Many informal credit groups have been operating in many countries for several years like the *susus* in Nigeria and Ghana, *chit funds* and Rotating Savings and Credit Associations (ROSCAs) in India, *tontines* in West Africa, *pasanaku* in Bolivia, *hui* in China, *arisan* in Indonesia, *paluwagan* in Philippines etc. It is believed that initially, the informal financial institutions emerged in Nigeria dating back in the fifteenth century. Such type of institutions started establishing in Europe during the eighteenth century when in 1720 the first loan fund targeting poor people was founded in Ireland (Seibel, 2005).

In 1847, some credit co-operatives were created in Germany which served 1.4 million people by 1910. In 1880s the British controlled government of Madras in South India tried to use the German experiment to address poverty in India. This effort resulted in membership of more than nine million poor to credit co-operatives by 1946. During the same time the Dutch colonial administrators constructed a co-operative rural banking system in Indonesia which eventually became Bank Rakyat Indonesia (BRI), now one of the largest Microfinance Institutions (MFIs) of the world (Schwiecker, 2004). In the 1970s, a paradigm shift started to take place. The failure of subsidized government or donor driven institutions to meet the demand for financial services in developing countries led to several new approaches. Bank Dagan Bali (BDB) established in Indonesia in 1970, was the earliest bank to institute commercial microfinance (Schwiecker, 2004). In 1973, ACCION International, a USA based NGO, disbursed its first loan in Brazil at commercial interest rate to start a micro-enterprise. One year later in 1974, the Self-Employed Women's Association of India (SEWA) started a bank to provide loans to poor women. In a SEWA BANK study, the proportion is about 40% compared with 50% and 62% of saver only and non-client households, respectively. The median income is 30% and 61% higher than for a saver-only and non-client household, respectively. Borrower and saver-only enrollment rates (both 58%) were both greater than the rate for non-client households (52%). Average daily expenditure on food is 21% higher than in non-client households. In contrast, saver only households enjoy only a small dietary margin over non-client households. Average daily expenditure on food is only 5% higher than in non-client households. The average number of income sources was 2.7 for client households compared with 2.5 for both saver-only and non-client households. It is interesting to note that the net impact of the widespread closure of large textile mills in Ahmedabad City appears to be that the borrower households suffered greater setbacks (more jobs lost and less compensation paid) but were able to recover more quickly (more laid-off workers are currently economically active) than saver-only and non-client households. Interestingly, fewer other household members in borrower households (60%) than saver-only (73%) or non-client (74%) households took on additional work. In 1976, Muhammad Yunus, a professor of Economics at Chittagong University, Bangladesh initiated an experimental research project of providing credit to the rural poor. He gave a small loan of 856 Taka

(\$27) from his pocket to 42 poor bamboo weavers and found that small loans radically changed the lives of these people and they were able to pay back the loans with interest. The success of this idea led Yunus to establish Grameen Bank in 1983 in Bangladesh. This program showed astonishing growth rates in Bangladesh, particularly during the 1980s and 1990s. It encouraged social innovators and organisations all over the world to begin experiments with different microfinance delivery methods to bring financial services to the poor. It is now adopted worldwide in the countries of different continents. Many international NGOs, such as Foundation for International Community Assistance (FINCA), Americans for Community Cooperation in Other Nations (ACCION), Freedom from Hunger, Opportunity International, Co-operative for Assistance and Relief Everywhere (CARE), Consultative Group for Assisting the Poor (CGAP), etc. are promoting microfinance program for creating new businesses and combating poverty in a sustainable way. Over the past few decades, microfinance has been experimented in many developing countries. Bank Rakyat Indonesia (BRI) in Indonesia, Bancosol in Bolivia, Bank for Agriculture and Agricultural Co-operatives (BAAC) in Thailand, Grameen Bank, and Bangladesh Rural Advancement Committee (BRAC) of Bangladesh, NABARD in India, Amanah Ikhtiar Malaysia (AIM) of Malaysia, Agriculture Development Bank of Nepal (ADB), K-Rep in Kenya and Mibanco in Peru have yielded encouraging results in alleviating poverty and empowering the poor through microfinance.

In India, the first initiative to introduce microfinance was the establishment of Self-Employed Women's Association (SEWA) in Gujarat. SEWA was registered as a trade union of self-employed women workers of the unorganised sector in 1972. This trade union established their bank known as SEWA Bank in 1974. To establish this bank four thousand union members contributed Rs. 10 each as share capital. Since then this bank is registered as a co-operative bank and has been providing banking services to poor women and has also become a viable financial venture. In the midst of the apparent inadequacies of the formal financial system to cater to the financial needs of the rural poor, the first major effort to reach these rural poor was made by NABARD in 1986-87, when it supported and funded an action research project on 'Saving and Credit Management of Self-Help Groups' of Mysore Resettlement and Development Authority (MYRADA). For this purpose, a grant

of Rs. one million was provided to MYRADA. The encouraging results were yielded. In 1988-89, NABARD undertook a survey of 43 NGOs spread over eleven states in India to study the functioning of the SHGs and possibilities of collaboration between the banks and SHGs in the mobilisation of rural savings and improving the credit delivery to the poor. Encouraged by the results of field level experiments in group based approach for lending to the poor, NABARD launched a pilot project of linking 500 SHGs with banks in 1991-92 in partnership with non-governmental organisations (NGOs) for promoting and grooming self-help groups of socio-economically homogeneous members. In order to meet their credit requirements, in July 1991 RBI issued a circular to the commercial banks to extend credit to the SHGs formed under the pilot project of NABARD. During the project period different NGOs like Association of Sarva Seva Farms (ASSEFA), Madras; People's Rural Education Movement (PREM), Berhampur; Professional Assistance for Development Action (PRADAN), Madurai; and Community Development Society (CDS), Kerala promoted hundreds of groups. The results were very encouraging. In February 1992, the launching of pilot phase of the SHG- Bank Linkage Program (SHG-BLP) could be considered as a landmark development in banking with the poor.

In order to further promote this program RBI issued instructions to banks in 1996 to cover SHG financing as a mainstream activity under their priority sector-lending portfolio. The program acquired a national priority from 1999 through Government of India budget announcements. With the support from both the government and the Reserve Bank of India, NABARD successfully spearheaded the program through partnership with various stakeholders in the formal and informal sector. Since the time of its origin, NABARD provides policy guidance, technical and promotional support mainly for capacity building of NGOs and SHGs. Realising the potential in the field of microfinance, the government allowed various private players to provide microfinance in the country. These private microfinance providers, commonly known as MFIs, are various NGOs, Non-banking Financial Companies (NBFCs) and other registered companies. Many state governments amended/passed their State Co-operative Acts to use co-operative societies for providing microfinance. These days many public and private commercial banks, regional-rural banks, co-operative banks, co-operative societies, registered and unregistered NBFCs, societies,

trusts and NGOs are providing microfinance by using their branch network and through different microfinance delivery models.

Legal legislation in India for financial support to Micro Enterprises

The Asian Development Bank (2000) defines microfinance as the provision of a broad range of services such as savings, deposits, loans, payment services, money transfers and insurance to poor and low income households and their micro-enterprises. This definition of microfinance is not restricted to the below poverty line people but it includes low income households also. The Task Force I (A group of senior Government officials and prominent microfinance practitioners constituted by NABARD) terms microfinance as the provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards. The Task Force II emphasizes that microfinance will cover not only consumption and production loans, but also loans for other credit needs such as housing and shelter. The Micro Financial Sector (Development and Regulation) Bill, (2007) defines microfinance as the provision of financial assistance and insurance services to an individual or an eligible client either directly or through a group mechanism for an amount, not exceeding rupees fifty thousand in aggregate per individual for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual); or an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing or other prescribed purposes. The eligible clients which may get financial assistance under this scheme may be landless laborers and migrant laborers; artisans and micro-entrepreneurs; disadvantaged cultivators of agricultural land including oral lessees, tenants, and share croppers; and farmers owning not more than two hectares of agricultural land. With the enactment of MSME ACT 2006 Micro finance to Micro Enterprises has become inevitable and paved the way for inducing legitimate power among poor for their economic development.

Challenges of Financial support to poor for Economic Development

The academic studies show that: "Microfinance programs face unusual challenges in making sure their services reach even the poorest of economically active households. A major obstacle

is a set of assumptions of the community of academics, donors and practitioners supporting microfinance programming. They assume that the design of microfinance, especially poverty-oriented, group-based microfinance, creates a desirable bias toward the poor (or more accurately, against the not-so-poor). The small loan size, high interest rate, short loan duration (too short for many kinds of investment, especially for most types of production agriculture), the frequent repayments (initially weekly in most programs), and dependence on mutual guarantees are all factors assumed to make the program unattractive to people who have other sources of easier credit. It is assumed that the poor, with few, if any, other options (because they lack collateral and distinct businesses), will tolerate these unattractive features, while the not-so-poor, for whom easier options are available, will tap more attractive sources of credit

"A few years ago an influential book that included case studies of 12 MFIs in Asia, Africa, and Latin America argued that MFIs working with the poorest would experience a trade-off with IFS. Specifically, it concluded that, "at a given point in time [MFIs] can either go for growth and put their resources into underpinning the success of established and rapidly growing institutions, or go for poverty impact...and put their resources into poverty-focused operations with a higher risk of failure and a lower expected return" (Hulme & Mosley, 1996, p.20). Despite the influence of Hulme and Mosley's study, it is now recognized among many that the alleged trade-off is not inevitable (Christen, 1997; Christen and others, 1995; and Gulli, 1998, p. 28). A study of 11 successful microfinance programs in three continents found that, "Among high-performing programs (current authors' emphasis), no clear trade-off exists between reaching the very poor and reaching large numbers of people" (Christen and others, 1995, p. viii70), and concluded that their results showed that, "...full self-sufficiency can be achieved by institutions serving the very poor...." (Christen and others, 1995). Thus it is not the clientele served that determines an MFI's potential for IFS, but the degree to which its financial services program is well-designed and managed." (p. 4)

This study examined three MFIs: The Center for Agriculture and Rural Development (CARD) a Grameen Bank replication/adaptation based in the Philippines (Operating Self-sufficiency—OSS—of 102.2%; Institutional Financial Self-sufficiency—IFS—of 95.9%; sample found that 53% of those who joined before CARD became a bank and 63% of those who entered after the bank had been established lived in the poorest houses. Average labor productivity in enterprises was 34% higher than the market wage rate. Rate of return on capital was 117% compared to 46% (effective) rate of interest charged by CARD. Credito con Educacion Rural (CRECER) a Freedom from Hunger Credit with Education affiliate and village-banking program based in Bolivia OSS—93.8%; IFS—85.0%—due to aggressive expansion plan; and approximately 49% of clients are ‘extremely poor’

The Foundation for International Community Assistance (FINCA Uganda), a village banking program based in Uganda (OSS—105.5%; IFS—79.7%—due to failure of Co-Operative Bank of Uganda with which they held 30% of cash and in which 80% of clients kept their savings; 67% of clients enter in severe poverty defined as a daily per capita income or DPCI of less than US\$1 with an average of US\$0.56. 22% were ‘moderate poor’ with an average DPCI of US\$1.39) “So it is clear that MFIs serving and benefiting substantial numbers of the poorest clients in their countries can be at or near operational self-sufficiency, not too far from IFS, and making progress toward both. They need not experience a trade-off between working with the poorest and institutional financial sustainability.” (Christen 1996)

“Several authors, including Hulme and Mosley (1997) have noted that “Worryingly, both BRACRDP and Grameen Bank recently appear to be moving away from working with significant proportions of the hard core poor and focusing their activities on the middle income and upper poor, rather than the most desperate.” This generally attributed to the increasing emphasis on institutional sustainability which Hulme and Mosley (1996, 1997) and Rogaly (1996) see as “Furthermore as Rhyne (1994); Christen et al. (1996) and many others point out, the greater the Microfinance institution’s outreach, (i.e. the more clients it serves) the more cost effective and sustainable it becomes. In most development initiatives, the more people you serve, the greater the cost becomes; with Microfinance initiatives,

the opposite is true.” (p. 35) “It is clear that, in these days of dwindling development budgets, the cost-effectiveness and sustainability of interventions is one of the most important criteria for programming funds. It is here that Microfinance has a particular advantage over almost (and probably) all other interventions....” (p. 39)

Macroeconomic policies linked to structural adjustment processes, although subsequently oriented in ways that tended to limit or minimize social problems, could hardly bring about a lasting solution. Such policies support the traditional approach, in which poverty is deemed to be alleviated by top-down money transfers initiated by the State in the direction of the poor. Yet public money transferred to the poor can provide only short-term relief to their situations simply because nowhere is public (or donor) money in infinite supply. In the short- and medium-term, macroeconomic policies are bound to work in zero-sum-game environments where money transferred to the poor is necessarily taken from other segments of the economy, a decision always difficult to take at the government level. Furthermore, and of greater importance, the example of developed countries clearly showed that more money allocated to poverty by the government did not necessarily mean less poverty or less exclusion in society, even in the short term. On the contrary, the permanence of public transfers to some categories of people often created frozen situations where none of the actors involved in the poverty struggle had any incentive to move or change. At a time when governments are incurring heavy budget deficits, the question arises as to whether the cost of the anti-poverty effort should be shared further by the poor and by the private sector at large.

The income-generating approach described in the preceding paragraphs already allows part of that effort to be shared by the poor themselves. Credit, combined with the effort and skills of the entrepreneurial poor, can create the conditions necessary for the development of income-generating activities. Scarce public money earmarked for poverty eradication is then leveraged through credit and is unlikely to create programs suitable for and focused on that group. The sustainability and profitability of micro-credit programs in the developing world are achievable. Empirical indications are that the poorest can benefit from microfinance from both an economic and social well-being point-of-view, and that this can be done

without jeopardizing the financial sustainability of the MFI. While there are many biases presented in the literature against extending microfinance to the poorest, there is little empirical evidence to support this position. However, if microfinance is to be used, specific targeting of the poorest will be necessary. Without this, MFIs which and the rate at which sustainability is achievable is a function of the goals of the program, the target population, etc. There are examples that serving the poor can be sustainable.

In the recent years, though money lending through MFIs has become a major financial activity in the villages, barbaric and inhuman methods such as harassing borrowers, intimidating, abusing, mentally and physically harassing them have been incorporated into the whole process of money lending. The borrowers are always under the pressure to repay the loan (on a weekly basis) at a heavy compound interest for petty loans they take.

Another argument is that MFIs lend money at exorbitant interest rates which range from 20 percent to 40 percent. This ugly face of MFIs gives us a vivid picture of the dark underbelly which is now making its way into the media.

In the name of empowering the poor, this form of organized exploitation has given many reasons for businessmen to make money at the cost of the poor, who are often seen as “*fortune at the bottom of the pyramid.*” Previously, money lenders lent money at higher rates of interest because it was the individual who was lending money, but now, it is an institution comprising of a group of individuals who are lending money and in turn, pocketing extra money from the poor in the name of interest rate.

For example: In Andhra Pradesh, Reserve Bank of India (RBI) wanted to de-recognize many MFIs that were indulged in compelling women from Khammam, Warangal, Mahbubnagar and several coastal Andhra districts to enroll themselves to be beneficiaries at MFIs. Caught in a debt trap, many borrowers committed suicide. In the name of loan recovery, human rights were grossly violated. When the policy makers say that MFIs are a medium of financial inclusion of the poor, one must read this example published in the Economic Times to know whether MFIs are including or isolating the poor from the society.

“A woman who takes Rs 10,000 loan from a microfinance institution has to pay Rs 225 every week. If she is unable to make this payment or has another emergency in the house, she will take a loan. The existing lender will not give you a fresh loan till the old one is at least 35 weeks old, so she will borrow from another MFI.

That’s another Rs 225 every week. Weighed down, she will take a third loan in a matter of months. Now she has to pay Rs 675 every week! And so, a fourth loan. Such women are forever wondering where their next installment will come from. Some are working as far labor to repay loans. If they are unable to fully repay, they sell cattle, land or jewellery.”

While we analyze how MFIs are more or less like slow poison to these “beneficiaries”, what one has to look at is that the RBI allows MFIs to reach those places where banks cannot make their way. But, under certain norms, which are often changeable or overlooked at the cost of poor people’s lives, MFIs have set up shops.

But, there have been models of lending money through MFIs in Indonesia and Pakistan, which have been successful. In Indonesia, 13 banks under the Central Bank, 12 NGOs have lent money to 420 self-help groups (SHGs) in which internal lending among the beneficiaries was allowed and no credit would be granted to an SHG without savings by the individual members of SHG. This helped every member save money to repay the loan as well as to save it for them.

In Pakistan, an organization called “Akhuwat” provided loans to beneficiaries at zero percent interest, except that the time period for repaying the amount was fixed. This led to the creation of pool of money for the poor and has attracted more than 50,000 honest people to be a part of this.

Now, if we compare MFIs with rural banks (public sector banks), rural banks give loans to members of SHGs at 14 percent interest rate and can increase the loan repayment period, considering the economic status of the beneficiary. Also, rural banks provide the beneficiaries with extra loans to clear other debts (if any). But, the SHG members have to save money every month in order to deposit it in the bank as their savings. These banks also allow internal lending of money which enables each member to save money, apart from generating income.

So, if financial inclusion of the poor is the main agenda, then increasing the flow of funds to the informal sector would be an advantage because the profits will reach the low income group borrowers. Access to the flow of funds in the formal sector would facilitate competition within informal sector and increase the efficiency.

Secondly, participatory budgeting model followed in Venezuela exemplifies how people participate in a community’s activities and plan the budget according to the requirements of the members in the community who are represented by elected leaders. Money lending is a part of this structured process in which a member of the community is appointed to check the flow of capital. This brings in transparency and gives power to the people to make decisions based on their needs and necessities and also to generate income.

An institution that would combine the strengths of an NGO and that of a financial institution would be beneficial to a community. But, the reliability factor on such institutions is always questionable because there is a risk of these institutions becoming like the regular MFIs which petrify the beneficiaries to repay loans. So, this model should enable members of a community to have access and control over the financial resources.

Finally, it all boils down to a question which tests the credibility of these suggested solutions. Corruption, lack of proper implementation and misuse of funds have dogged everything in our society till date, so why wouldn't these suggestions be victims of such cruelty? Transparency is the only way out.

If we think that only the traditional money lenders are guilty of such heinous crime, so are the micro finance institutions.

Suggestions

Microfinance is not for everyone. Most importantly, entrepreneurial skills and ability are necessary to run successful microenterprise and not all potential customers are equally able to take on debt. While these points will be true globally across all strata of poverty. It is assumed that they will have a greater effect on the very poorest. The sick, mentally ill, destitute etc. who form a minority of those living the below poverty line are typically not good candidates for microfinance. Most researchers agree that this group of people would be better for direct assistance. More optimistically, microfinance can be effective for a broad group of clients, including those who are living in the bottom half of those below a country's poverty line Micro Enterprises are generally not registered but they are contributing for employment generation and Economic Development. Financial support in the form of Micro Finance can be a powerful tool for the employment generation and economic development

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