MICRO FINANCE IN INDIA: FIRST STAGE TO ERADICATE POVERTY

1. V. Sai Chitra, B.A (EPP) 2nd YEAR, B.J.R Government Degree College, Narayanaguda, Hyderabad, T.S-500029.
2. Dr.D.Muniswamy, Assistant Professor of Economics, B.J.R Government Degree College, Narayanaguda, Hyderabad, T.S-500029.
3. Sri M.Pandarinath, Lecturer in Economics, B.J.R Government Degree College, Narayanaguda, Hyderabad, T.S-500029.

ABSTRACT:

"The moment you say Microfinance everybody wants to help you" - Muhammad Yunus

In a country like India where 70 percent of its population lives in rural area and 60 percent depend on agriculture, Microfinance can play a vital role in providing financial services to the poor and low-income individuals. Microfinance is regarded as a useful tool for socio economic up-liftment in a developing country like India. It is expected to play a significant role in poverty alleviation and development. The emphasis of present paper is to study the performance and role of microfinance institutions in the development of India. India is one of the highly populated countries in the world currently. Reason being unawareness, illiteracy, avoidance or disinterest; in turn leading to economic downfall and almost 30-35% of the people are under the Below Poverty Line (BPL). These people are not even able to meet their consumption need. Therefore, there is a need of a tool that not only serves them but also make them self-capable, Microfinanceis such an approach that would result in the better standard of living for them.

KEY WORDS: Growth of Micro Finance, Tool for alleviating poverty, Standard of Living

MICROFINANCE:

Mohammad Yunus, who was the professor of Economics and awarded the Noble Prize in Economics in 2006 for the efforts in developing social economic improvements through microcredit and microloan operations. Most notably Yunus founded the Grameen Bank, which is known for Loaning billions of dollars to improveshed people all over the world. When he was teaching economics in his native Bagladesh, Younus became aware of the extreme poverty in the country and the refusal of banks to offer credit to poor people. He responded by telling them the money himself, confident that the very poorest could raise their small business activity and their station with very small loans

Microfinance recognises that poor people are remarkable reservoir of energy and knowledge. Microfinance is a category of financial services targeting individuals and small businesses that lack access to conventional banking and related services. Microfinance includes microcredit, the provision of small loans to poor clients; savings and checking accounts; microinsurance; and payment systems, among other services.Microfinance services are designed to reach excluded customers, usually poorer population segments, possibly socially marginalized, or geographically more isolated, and to help them become self-sufficient.

Microfinance initially had a limited definition: the provision of microloans to poor entrepreneurs and small businesses lacking access to credit.The two main mechanisms for the delivery of financial services to such clients were:

1. Relationship-based banking for individual entrepreneurs and small businesses; and
2. Group-based models, where several entrepreneurs come together to apply for loans and other services as a group.

Over time, microfinance has emerged as a larger movement whose object is: "A world in which as everyone, especially the poor and socially marginalized people and households have access to a wide range of affordable, high quality financial products and services, including not just credit but also savings, insurance, payment services, and fund transfers."

Proponents of microfinance often claim that such access will help poor people out of poverty, including participants in the Microcredit Summit Campaign. For many, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses; for others it is a way for the poor to manage their finances more effectively and take advantage of economic opportunities while managing the risks. Critics often point to some of the ills of micro-credit that can create indebtedness. Many studies have tried to assess its impacts.

New research in the area of microfinance call for better understanding of the microfinance ecosystem so that the microfinance institutions and other facilitators can formulate sustainable strategies that will help create social benefits through better service delivery to the low-income population.

Microfinance is a way in which loans credit insurance access to savings accounts and money transfers are provided to small business owners and entrepreneurs in the under developed parts of India. The beneficiaries of microfinance are those who do not have access to these traditional financial resources. Then interest rates on micro loans are generally higher than that on traditional personal loan.

Types of Microfinance: Microfinance includes the following products:

- Micro Loans - Microfinance loans are significant as these are provided to borrowers with no collateral. The end result of microloans should be to have its recipients outgrow smaller loans and be ready for traditional bank loans.

- Micro Savings – Micro savings accounts allow entrepreneurs operate savings accounts with no minimum balance. These accounts help users inculcate financial discipline and develop an interest in saving for the future.
- Microinsurance - Microinsurance is a type of coverage provided to borrowers of microloans. These insurance plans have lower premiums than traditional insurance policies.

In some situations, recipients of microloans are expected to take some training courses, such as cash flow management or book-keeping.

Importance of Microfinance:

Almost half of the population of our country does not have a basic savings account. However, this segment requires financial services so that their aspirations such as building of assets and protection against risk can be fulfilled.

Microfinance provides access to capital for individuals who are financially underserved. If microfinance institutions were not offering loans to this segment of the society, these groups would have resorted to borrowing money from friends or family members. The probabilities of them opting for fast cash loans or payday advances (that bear huge interest rates) are also high.

Microfinance helps these groups invest wisely in their businesses, and hence, is in alignment with the government's vision of financial inclusion in the country.

Highlights:

1. Microloans in the range of Rs.20,000 – Rs.30,000 are availed the most in India. However, the category of loans in the range of Rs.30,000 - Rs.40,000 saw a rise of 56% between Q3 FY18 and Q3 FY19.
2. The microfinance industry has registered a growth of 44% YoY as on 31 March 2019. (As per CRIF High Mark Report)

Key Features of Microfinance:

Some of the significant features of microfinance are as follows:

- The borrowers are generally from low-income backgrounds
- Loans availed under microfinance are usually of small amount, i.e., micro loans
- The loan tenure is short
- Microfinance loans do not require any collateral
- These loans are usually repaid at higher frequencies
- The purpose of most microfinance loans is income generation

Role of Microfinance Institutions (MFIs):

Microfinance services are offered by the following sources:

- Formal institutions, i.e., cooperatives and rural banks
- Semiformal institutions, i.e., non-government organisations
- Informal sources, such as shopkeepers and small-scale lenders

Institutional microfinance encompasses the services provided by both formal and semiformal institutions.

A microfinance institution specialises in banking services for low-income individuals and groups. These institutions access financial resources from mainstream financial entities and provide support service to the poor. Microfinance institutions are hence, emerging as one of the most effective tools in reducing poverty in India.

While several MFIs are well-run with great historical records, others are operationally self-sufficient.

The different types of institutions offering microfinance in India are:

- Commercial banks
- Credit unions
- Non-governmental organisations (NGOs)
- Sectors of government banks
- Cooperatives

Microfinance institutions act as a supplement to the services offered by banks. Apart from offering micro credit, financial services such as insurance, savings, and remittance are provided. Non-financial services such as training, counselling, and supporting borrowers are offered in the most convenient manner as well.

Points to note:

- The borrower gets the above-mentioned services at their convenience.
- The repayment schedule is also decided by the borrower.
- Interest rates charged by MFIs are usually higher than that of traditional banks.
- Interest rates vary widely based on the loan purpose and borrower history.

Thought-Provoking Facts on Microfinance:

- It is seen that mobile phones are increasingly being used as banking channels in the microfinance market around the world. While it is making headway in countries like the United States and Kenya, mobile phones have not yet found popularity as a banking channel in the remote areas of India.
- Women are major borrowers of microfinance across the world. Most of these women reside in rural parts as well.
- The Indian microfinance industry has been growing the fastest when compared to other developing nations like Bangladesh, Vietnam, and Peru.
- Microfinance loans have high repayment rate. This is clearly proof of the effectiveness of this concept.

In developing economies, and particularly in rural areas, many activities that would be classified in the developed world as financial are not monetized: that is, money is not used to carry them out. This is often the case when people need the services money can provide but do not have dispensable funds required for those services. This forces them to revert to other means of acquiring the funds. In their book, *The Poor and Their Money*, Stuart Rutherford and Sukhwinder Arora cite several types of needs:

- *Lifecycle Needs*: such as weddings, funerals, childbirth, education, home building, holidays, festivals, widowhood and old age
- *Personal Emergencies*: such as sickness, injury, unemployment, theft, harassment or death
- *Disasters*: such as wildfires, floods, cyclones and man-made events like war or bulldozing of dwellings

- *Investment Opportunities*: expanding a business, buying land or equipment, improving housing, securing a job, etc.

People find creative and often collaborative ways to meet these needs, primarily through creating and exchanging different forms of non-cash value. Common substitutes for cash vary from country to country, but typically include livestock, grains, jewelry and precious metals. As Marguerite S. Robinson describes in his book, *The Micro Finance Revolution: Sustainable Finance for the Poor*, the 1980s demonstrated that "micro finance could provide large-scale outreach profitably", and in the 1990s, "micro finance began to develop as an industry".In the 2000s, the microfinance industry's objective was to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty. While much progress has been made in developing a viable, commercial microfinance sector in the last few decades, several issues remain that need to be addressed before the industry will be able to satisfy massive worldwide demand. The obstacles or challenges in building a sound commercial microfinance industry include:

- Inappropriate donor subsidies
- Poor regulation and supervision of deposit-taking microfinance institutions (MFIs)
- Few MFIs that meet the needs for savings, remittances or insurance
- Limited management capacity in MFIs
- Institutional inefficiencies
- Need for more dissemination and adoption of rural, agricultural microfinance methodologies
- Members' lack of collateral to secure a loan

Microfinance is the proper tool to reduce income inequality, allowing citizens from lower socio-economical classes to participate in the economy. Moreover, its involvement has shown to lead to a downward trend in income inequality.

Impacts and criticism:

Most criticisms of microfinance have actually been criticisms of microcredit. Criticism focuses on the impact on poverty, the level of interest rates, high profits, over indebtedness and suicides. Other criticism includes the role of foreign donors and working conditions in companies affiliated to microfinance institutions, particularly in Bangladesh.

Impact:

The impact of microcredit is a subject of much controversy. Proponents state that it reduces poverty through higher employment and higher incomes. This is expected to lead to improved nutrition and improved education of the borrowers' children. Some argue that microcredit empowers women. In the US and Canada, it is argued that microcredit helps recipients to graduate from welfare programs.

Criticism:

Critics say that microcredit has not increased incomes, but has driven poor households into a debt trap, in some cases even leading to suicide. They add that the money from loans is often used for durable consumer goods or consumption instead of being used for productive investments, that it fails to empower women, and that it has not improved health or education. Moreover, as the access to micro-loans is widespread, borrowers tend to acquire several loans from different companies, making it nearly impossible to pay the debt back. As a result of such tragic events, microfinance institutions in India have agreed on setting an interest rate ceiling of 15 percent. This is important because microfinance loan recipients have a higher level of security in repaying the loans and a lower level of risk in failing to repay them.

Unintended consequences of microfinance include informal intermediation: That is, some entrepreneurial borrowers become informal intermediaries between microfinance initiatives and poorer micro-entrepreneurs. Those who more easily qualify for microfinance split loans into smaller credit to even poorer borrowers. Informal intermediation ranges from casual intermediaries at the good or benign end of the spectrum to 'loan sharks' at the professional and sometimes criminal end of the spectrum.

Criticism of Microfinance:

Microfinance has been lauded by many, as it is a clear passage to end the cycle of poverty, aid the marginalised sections, decrease unemployment, and improve their earning power. However, it has also received criticism from certain corners, as it was argued that microfinance actually makes poverty worse. The fact that some borrowers of microfinance use these loans to pay off their existing debts or fund their basic necessities reinforce these arguments.

The situation is more adverse in countries like South Africa where majority of microfinance loans are consumed by the borrower for basic necessities. When borrowers do not generate new income from the initial loan, they are forced to take out more loans to repay the former. This simply snowballs into a bigger debt trap.

Conclusion:

According to Kofi Annan "Microfinance recognizes that poor people are remarkable reservoirs of energy and knowledge, posing an untapped opportunity to create markets, bring people in from the margins and give them the tools with which to help themselves"

Microfinance can contribute to solving the problems of inadequate housing and urban services as an integral part of poverty alleviation programs and it stands as one of the most promising and cost-effective tools in the fight against global poverty. It would be ideal to enhance the credit worthiness of the poor and to make them more 'bankable'.

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