

## MICRO FINANCE AND POVERTY REDUCTION IN INDIA

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### **Abstract:**

*India falls under 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. 60% of people depend on agriculture, as a result there is chronic Underemployment and per capital income is very low. Micro- finance is often advocated as a solution to multiple social problems in India. Poor persons with access to credit can make investments in enterprises that bring them out of poverty. In the present era there is a need for practical and workable solution to improve the socioeconomic conditions of the poor in India, thereby helping in wiping out the deep-rooted problem of poverty.*

*The paper attempts to analyze that role of microfinance Institution in poverty reduction, Highlights of Microfinance Terminology and some issue faced Microfinance Institutions in India.*

### **KEYWORDS:**

Microfinance, Poverty Reduction, Microfinance Institution, NGOs, SHGs.

### **INTRODUCTION**

India has the one of the fast developing country in the world India's 'first world' economy is oriented to the very highest standards of globalise consumption, and formal sector incomes and lifestyles reflect this. By contrast, the real incomes and 'lifestyles' of the very poor, particularly in rural areas, are comparable very low. Micro- finance is often advocated as a solution to multiple social problems in India. Poor persons with access to credit can make investments in enterprises that bring them out of poverty. Over the last few years, savings and credit groups have also helped to manage some important social programs of the Indian government, such as the distribution of food grains and school meals in state primary schools.

In the present era there is a need for practical and workable solution to improve the socioeconomic conditions of the poor in India, thereby helping in wiping out the deep-rooted problem of poverty.

Globalization has brought substantial benefits around the world, but in many developing countries it is contributing to a growing disparity between the rich and the poor. Microfinance emerged as a noble substitute for informal credit and an effective and powerful instrument for poverty reduction among people.

### **OBJECTIVE OF THE STUDY**

- 1)To analyze the growth of microfinance sector developed in India and to see the potential for the microfinance institutions, NGOs, SHGs in the market.
- 2)To analyze the structure and pattern of microfinance programme in rural Indian by the MFIs, NBFCs
- 3)To find out issues faced by micro finance institution.

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## RESEARCH METHODOLOGY

### Data Collection

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

### DEFINITION OF MICRO-FINANCE

Micro- finance is defined as, “financial services such as saving A/C, Insurance Fund and Credit provided to poor & low income clients so as to help them to rise their income and there by improve their standard of living.”

From this definition it is clear that main features of Micro Financing.

- 1] Loan are given without security.
- 2] Loan to those people who live BPL ( Below Poverty Line)
- 3] Even members of SHG enjoy Micro Finance.
- 4] Maximum limit of loan under micro finance Rs. 25000/-
- 5] The terms and conditions given to poor people are decided by NGOs.
- 6] Micro Finance is different from Micro credit- under Micro credit, Small amount of loans given to the borrower but under Micro Finance besides loans many other financial services are provided such as saving A/c, Insurance etc. Therefore Micro Finance has wide concept as compared to Micro Credit.

### Channels of Micro finance

In India microfinance operates through two channels:

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

### SHG – Bank Linkage Programme

This is the bank-led microfinance channel which was initiated by NABARD in 1992. Under the SHG model the members, usually women in villages are encouraged to form groups of around 10-15. The members contribute their savings in the group periodically and from these savings small loans are provided to the members. In the later period these SHGs are provided with bank loans generally for income generation purpose. The group's members meet periodically when the new savings come in, recovery of past loans are made from the members and also new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular. The SHGs are self-sustaining and once the group becomes stable it starts working on its own with some support from NGOs and institution like NABARD and SIDBI.

### Micro Finance Institutions

Those institutions which have microfinance as their main operation are known as micro finance institutions. A number of organizations with varied size and legal forms offer microfinance service. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee. The reason for existence of separate institutions i.e. MFIs for offering microfinance are as follows:

High transaction cost – generally micro credits fall below the break-even point of providing loans by banks  
Absence of collaterals – the poor usually are not in a state to offer collaterals to secure the credit  
Loans are generally taken for very short duration periods  
Higher frequency of repayment of installments and higher rate of Default

Non-Banking Financial Companies (NBFCs), Co-operative societies, Section-25 companies, Societies and Trusts, all such institutions operating in microfinance sector constitute MFIs and together

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they account for about 42 percent of the microfinance sector in terms of loan portfolio. The MFI channel is dominated by NBFCs which cover more than 80 percent of the total loan portfolio through the MFI channel.

Sl. No.	Type of MFI	Number	Legal Registration
<b>Not-for Profit MFIs</b>			
1	NGOs	400-500	Society Registration Act, 1860 Indian Trust Act, 1882
2	Non-Profit companies	20	Section-25 of Indian Companies Act, 1956
<b>Mutual Benefit MFIs</b>			
3	Mutual benefit MFIs – Mutually Aided Cooperative Societies (MACS)	200-250	Mutually Aided Co-operative societies, Act enacted by State Governments
<b>For Profit MFIs</b>			
4	Non-Banking Financial Companies (NBFCs)	45	Indian companies Act, 1956 Reserve Bank of India Act, 1934

( Source:- NABARD ISSUES RELATED TO MICROFIANCE, Legal structure and regulation )

Although the SHG-Bank linkage model is well managed in India by NABARD, currently there is no proper regulatory body for the supervision of MFIs. The presence of institutions with a variety of legal forms makes it difficult for the regulation of all such institutions by a single regulatory body in the current Indian legal structure. Though NBFCs, which cover the major part of the outstanding loan portfolio by the microfinance channel, are regulated by Reserve Bank of India, other MFIs like societies, trusts, Section-25 companies and cooperative societies fall outside the purview of RBI's regulation. The acceptance of the Malegam committee recommendations by the RBI is a big step forward in addressing the above concern but again it will cover only a section of the MFIs i.e. NBFCs. The microfinance bill which was introduced in the year 2007 is still pending. The most recent and the strongest step taken by the government, The Micro Finance Institutions (Development and regulation) Bill, 2011 is a major step in the microfinance sector. The proposed bill clarifies all doubts pertaining to regulation of the MFIs by appointing RBI as the sole regulator for all MFIs.

## ROLE OF MICRO FINANCE INSTITUTIONS IN POVERTY REDUCTION

### 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.

### 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 groups (SHGs) of women as a source 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

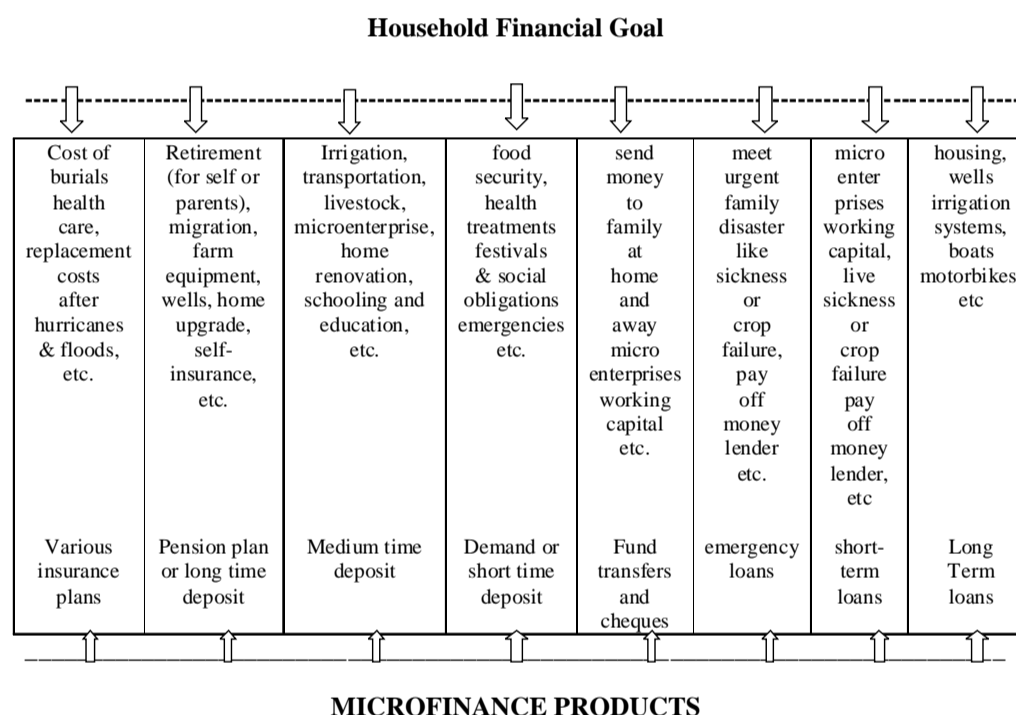
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well as in the society. Hence, women were the main target groups under SHG programme. Microfinance can provide an effective way to assist and empower poor women, who make up a significant. Proportion of the poor and suffer from poverty.

**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.

**TYPES OF MICROFINANCE USED BY POOR PEOPLE**



(Source :- Brett Matthews Mathwood consulting Company)

**MICROFINANCE TERMINOLOGY**

**Micro credit:** This is a small amount of money loaned to a client by a bank or other institution. Micro credit can be offered, often without collateral, to an individual or through group lending.

**Microfinance:** This refers to loans, savings, insurance, transfer services and other financial products targeted at low-income clients

**Micro insurance:** This is a system by which people, businesses and other organizations make payments to share risk. Access to insurance enables entrepreneurs to concentrate more on growing their businesses while mitigating other risks affecting property, health or the ability to work.

**Remittances:** These are transfer of funds from people in one place to people in another, usually across borders to family and friends. Compared with other sources of money that can fluctuate depending on the political or economic climate, remittances are a relatively steady source of funds.

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**Micro savings:** These are deposit services that allow people to store small amounts of money for future use, often without minimum balance requirements. Savings accounts allow households to save small amounts of money to meet unexpected expenses and plan for future investments such as education and old age.

**Inclusive financial sector:** It allows poor and low-income people to access credit, insurance, remittances and savings products. In many countries, the financial sectors do not provide these services to the lower income people. An inclusive financial sector will support the full participation of the lower income levels of the population.

**Micro entrepreneurs:** These are people who own small-scale businesses that are known as micro enterprises. These businesses usually employ less than 5 people and can be based out of the home. They can provide the sole source of family income or supplement other forms of income. Typical micro entrepreneur activities include retail kiosks sewing workshops, carpentry shops and market stalls.

**Bankable:** These people are those deemed eligible to obtain financial services that can lead to income generation, repayment of loans, savings, and the building of assets.

**Unbanked:** This describes people who have no access to financial services through any type of financial sector organization such as banks, non-bank financial institutions, financial cooperatives and credit unions, finance companies, and NGOs. Implicit in this definition is that financial services are usually available only to those individuals termed “economically active” or bankable.

## SOME ISSUE FACED MICROFINANCE INSTITUTIONS

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
2. Lack of Information
3. Financial Illiteracy
4. Inability to Generate Sufficient Fund
5. Migration of Group member

## CONCLUSION

Creating self employment opportunities is one way of attacking poverty and solving the problems of unemployment. There are over 24 Crore people below poverty line in our country. The Scheme of microfinance has been found as an effective instrument for lifting the poor above the level of poverty by providing them increased self-employment opportunities and making them credit worthy.

Microfinance is one of the ways of building the capacities of the poor and developing them to self-employment activities by providing financial services like credit, savings and insurance. To provide microfinance and other support services, MFIs should be able to sustain themselves for a long period. There are so many schemes for development of poor India. Creating self-employment opportunities through microfinance 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 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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