Micro Finance As A Tool For Financial Inclusion & Reduction Of Poverty

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ABSTRACT

Microfinance has assumed immense importance throughout the world in view of its efficacy in credit dispensation, loan repayment and reduction of poverty. The experience world over has proved that hassle free and repetitive dose of credit is the basic need of the poor which has become the hallmark of microfinance. Several countries like Bangladesh, Indonesia, Philippines, Kenya and Bolivia have implemented microfinance programmes with encouraging results.

In the Indian context, the microfinance sector has witnessed an unprecedented growth in the last few years, and has firmly established itself as significant potential contributor in the government’s agenda of “Financial Inclusion”. Financial services for the poor have proved to be a powerful instrument for poverty reduction that enables the poor to build assets, increase incomes, and reduce their vulnerability to economic stress.

Microfinance aims at providing broad range of financial services such as deposits, Loans, payment services, money transfers, insurance to poor and low-income households and their micro enterprises.

The paper highlights the roadblocks of micro finance in India. It looks into the attempts of selected organisations in the field of micro finance in India. The paper presents a glance into the government’s efforts in the field of micro finance.

Micro finance serves as an umbrella term that describes the provision of banking services by poverty focused financial institutions (micro finance institutions) to poor parts of the population that are not being served by mainstream financial services providers.

Key Words: Financial Inclusion, Micro Finance, Poverty, Self Help Groups

INTRODUCTION

In the Indian context, the microfinance sector has witnessed an unprecedented growth in the last few years, and has firmly established itself as significant potential contributor in the government’s agenda of “Financial Inclusion”. Financial services for the poor have proved to be a powerful instrument for poverty reduction that enables the poor to build assets, increase incomes, and reduce their vulnerability to economic stress. However, with nearly one billion people still lacking access to basic financial services, especially the very poor, the challenge of providing financial services to them remains. Convenient, safe, and secure deposit services are a particularly crucial need.

Microfinance sector is both old and new - people have always been borrowing, lending and saving for as long as there has been money (and in kind before). They have done this within their own communities, using their own systems and methods, without any external assistance or resources. The sector is new in that it has primarily developed as a response to the inability or apathy of commercial banks and the formal financial system to serve the needs of low-income households and micro enterprises.

Microfinance plays a significant role overarching goal to reduce poverty in India. Providing access to microfinance can prove to be an effective way of reaching the poor and improving their lives. The availability of adequate and timely microfinance services for low-income households has many effects on the development of a community. It can directly affect community organizing and development as a part of the microfinance activities, and it can also indirectly enable and facilitate community development as an externality of credit itself.

Microfinance is an enabling, empowering, and bottoms-up tool to poverty alleviation that has provided considerable economic and non-economic externalities to low-income households in developing countries. Microfinance is being hailed as a sustainable tool to combat poverty, combining a for-profit approach that is self-sustaining, and a poverty...
alleviation focus that empowers low-income households. Microfinance is increasingly becoming a tool to exercise developmental priorities for governments in developing countries. In order to ensure that the poorest benefit from this growth, and also contribute to it, the expansion and improvement of the microfinance sector should be a national priority. Micro-finance programmes have, in the recent past, become one of the more promising ways to use scarce development funds to achieve the objectives of poverty alleviation. Furthermore, certain micro-finance programmes have gained prominence in the development field and beyond. The basic idea of micro-finance is simple: if poor people are provided access to financial services, including credit, they may very well be able to start or expand a micro-enterprise that will allow them to break out of poverty.

MICRO FINANCE – AN OVERVIEW

Micro finance refers to the provision of financial services to poor or low income clients, including consumers and the self-employed. The term also refers to the practice of sustainably delivering those services. More broadly, it refers to a movement that envisions “a world in which as many poor and near poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance and fund transfers. Micro finance can be defined as small loans that help poor people who wish to start or expand their small businesses but are not able to get banks to lend to them. Micro credit is the extension of small loans to entrepreneurs too poor to qualify for traditional bank loans. It is helping millions of poor people, especially poor rural women; with tiny loans so they can start small, create self employment and improve their lives. Microfinance is the supply of loans, savings, and other basic financial services to the poor. People living in poverty, like everyone else, need a diverse range of financial instruments to run their businesses, build assets, stabilize consumption, and shield themselves against risks. Financial services needed by the poor include working capital loans, consumer credit, savings, pensions, insurance, and money transfer services. Microfinance aims at providing broad range of financial services such as deposits, Loans, payment services, money transfers, insurance to poor and low-income households and their micro enterprises.

OBJECTIVES OF THE STUDY

The objective of the present study is:
• To highlight the roadblocks of micro finance in India
• To have a glance at the government’s initiative in the sector of micro finance
• To look into the attempts of selected organisations in the field of micro finance

Area of Study

The paper is not confined to any particular area; on the other hand it is applicable to whole India. However, opinion of officers/managers of various banking and microfinance companies in Jaipur and Moradabad district of Rajasthan and Uttar Pradesh respectively has been taken about the growth, roadblocks and benefits of microfinance. Their views have been incorporated in this paper. The paper also takes the references of various articles written by various experts on microfinance. We have used qualitative research techniques as focus group discussion with respect to microfinance and financial inclusion in various microfinance companies. Our focus group discussion was based on some microfinance companies in region of Jaipur and Moradabad district. The discussions were based on key analysis of microfinance with emphasis on Financial Inclusion.

FINANCIAL INCLUSION

Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy. By financial inclusion we mean the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded. In the policy framework for development of the formal financial system in India, there is always an emphasis on the need for financial inclusion and covering more and more of the excluded population by the formal financial system.
In India the focus of the financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account without frills, to all. Internationally, the financial exclusion has been viewed in a much wider perspective. Having a current account / savings account on its own, is not regarded as an accurate indicator of financial inclusion. There could be multiple levels of financial inclusion and exclusion. At one extreme, it is possible to identify the ‘super-included’, i.e., those customers who are actively and persistently courted by the financial services industry, and who have at their disposal a wide range of financial services and products. At the other extreme, we may have the financially excluded, who are denied access to even the most basic of financial products. In between are those who use the banking services only for deposits and withdrawals of money. But these persons may have only restricted access to the financial system, and may not enjoy the flexibility of access offered to more affluent customers.

**IMPEding FINANCIAL INCLUSION**

There are several reasons for banks to shy away from the underprivileged:

1. Irregular income patterns,
2. Inadequate credit information,
3. Lack of collateral,
4. Illiteracy,
5. High transaction costs due to small sized loans,
6. Psychological and cultural barriers,
7. Population lacks knowledge of financial services

**SOME IMPORTANT FACTS**

1. 85000 bank branches are there in India but only 32000 branches cater to rural areas, which comprises of almost 70 percent of the nation’s population.
2. 73,000 unbanked villages with a population of 2,000 and above will be covered by March 2012, with at least five crore new accounts, promises the Swabhiman campaign.
3. Swabhimana, a national wide programme on financial inclusion launched in February 2011, is the largest initiative undertaken to provide banking service to the deprived.
4. 200 million or 17 percent of the country’s population are estimated to hold a bank account, while 800 million or 68 percent of the population owns mobile phones.
5. 80 percent of the Indian population is without life insurance, while 90 percent are excluded from the non-life insurance category.
6. The base of the pyramid population has seen large scale exclusion from the country’s mainstream banking system, due to indifference, the high operational costs and weak social collateral, amongst others.
7. Banks lending money to microfinance institutions, in order to meet their priority sector lending commitments, allowed MFIs to access credit at extremely low rates, driving up volumes and exacerbating the MFI crisis.
8. In recent times, we have seen a flurry of regulatory and policy action, seemingly in the name of “protecting the poor from markets”. For example, the Andhra Pradesh Government, through legislative action in October 2010 prevented an entire industry of microfinance institutions from carrying out their business due to perceptions that aggressive collection practices were hurting low income customers.

**HISTORY OF MICRO FINANCE IN INDIA**

The Micro finance activity is the result of NABARD’s work in the micro finance sector, which started in 1992 through a pilot project for promoting 500 self help groups (SHGs). As the idea gained acceptance from the banking system and the results were promising, the Reserve Bank of India (RBI) encouraged this positive initiative by issuing instructions to banks in 1996 to cover SHG financing as a mainstream activity under their priority sector–lending portfolio.

From 1999 onwards the Government of India (GOI) made linking SHGs with banks a national priority through its periodic policy and budget announcements. Today, the programme is growing at a pace of about 2.5 million households annually. It is the largest and fastest growing microfinance programme in the world in terms of its outreach and sustainability.

**SALIENT FEATURES OF MICRO FINANCE**

The salient features of micro finance are described herein below:

- It is a tool for empowerment of the poorest women.
It is essentially for promoting self-employment; the opportunities of wage employment are limited in developing countries - micro finance increases the productivity of self-employment in the informal sector of the economy - generally used for (a) direct income generation (b) rearrangement of assets and liabilities for the household to participate in future opportunities and (c) consumption smoothing.

It is not just a financing system, but a tool for social change, specially for women

Micro credit is aimed at the poorest; microfinance lending technology needs to mimic the informal lenders rather than the formal sector lending.

It has to provide for seasonality, allow repayment flexibility, eschew bureaucratic and legal formalities, fix a ceiling on loan sizes, etc.

The amount of loan is small, usually less than Rs. 20000.

It is lent for income generating activities;

The rate of interest charged varies from 10% to 15% flat thus offering a mind-boggling yield. The loan is repayable in small equated weekly installments, inclusive of interest.

The amount is collected on a weekly basis to ensure compliance.

The recovery rates are typically above 95 percent of the aggregate loans advanced.

MODELS OF MICRO FINANCE

There are two models of micro-finance which are prevalent in India:

Direct Financing Model: In this model (also known as Micro Finance Institution Model) the bank lends money to an NGO. The NGO promotes and imparts training to the Self Help Groups and also gives credit to them.

Self Help Group Bank Linkage Model: In this model SHGs act as a bridge between bankers and the grass root clients. Banks transfer funds to micro finance bodies that are responsible for disbursement and collection. The intermediation cost could be around 6% of the loan amount. The risk completely lies with the banks - the advances to the SHGs would be reflected in the portfolios of the banks. Banks do not mind taking the risk as servicing the grass-root level customers who are illiterate would otherwise involve a lot of transaction costs. A majority of these grass-root level customers have no means to produce ration card, identity card and even filling up application forms, which are the bare requirements to obtain loans in the normal course of bank lending operations. NABARD oversees the linking programme of banks to SHGs and offers refinance for it whereas SIDBI, through the SIDBI foundation for micro credit (SFMC) lends to Micro Finance Institutions. The Self-Help Group-Bank Linkage Programme implemented by commercial banks, Regional Rural Banks and Co-operative banks has emerged as a major micro finance programme in India, with 1.6 million SHGs being linked to banks in 2004-05 with the total flow of credit to them of over Rs. 6,800 crores.

OBJECTIVES OF MICRO FINANCE

The objectives of micro finance can be highlighted herein below:

- It provides a model of development that is Bottom up;
- It promotes entrepreneurship and gives people the means to brawl poverty;
- Micro-finance can be a powerful device in initiating a cyclical process of growth and development;
- Micro-finance activity can improve the access of rural poor to financial services;
- The micro-finance interventions help in inculcating necessary habits for economic independence and self-reliance. Appropriate and participatory credit plans by the members of a group can help in social and economic empowerment;
- Increased access signifies the overcoming of isolation of rural women in terms of their access to financial services and denial of credit due to absence of collateral security;
- The collection of savings generated out of very small but regular voluntary contributions improves access of the poor women to bank loans;
- It could also help in strengthening poor families’ resistance to external shocks and reducing dependence on moneymakers;
- The group utilizes its corpus to disburse loans of small amount amongst the needy members. In the beginning, the members meet out their consumption needs out of their own fund and afterwards they obtain loans from the Banks for taking up some economic activities for their sustained living.

CLIENTS OF MICRO FINANCE

The typical microfinance clients include:
• Low-income persons that do not have access to formal financial institutions;
• Self-employed, often household-based entrepreneurs;
• In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade;
• In urban areas, microfinance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc.

Microfinance clients are poor and vulnerable non-poor who have a relatively stable source of income. Microfinance generally targets poor women because they have proven to be reliable credit risks and when they have the financial means, they invest that money back into their families, resulting in better health and education, and stronger local economies. By providing access to financial services - loans and responsibility for repayment, maintaining savings accounts, providing insurance - microfinance programs send a strong message to households and communities. Studies have shown that women become more assertive and confident, have increased mobility, are more visible in their communities and play stronger roles in decision making.

MICRO FINANCE INSTITUTIONS

Micro Finance Institutions (MFIs) have emerged as important players in the rural credit delivery system. They are at present in significant numbers in the states of Andhra Pradesh, Tamil Nadu, Karnataka and Uttar Pradesh. A micro finance institution is an organisation that offers financial services to low income populations. Almost all give loans to their members, and many offer insurance, deposit and other services. MFIs can take many forms, but can be broadly grouped into the following categories:

• Non Banking Finance Companies (NBFC);
• Private Commercial Banks;
• Non Government Organisations (NGO);
• Not-for-Profit Companies registered under Section 25 of the Companies Act, 1956
• Cooperative Societies and
• Sections of Government Banks

Micro finance serves as an umbrella term that describes the provision of banking services by poverty focused financial institutions (micro finance institutions) to poor parts of the population that are not being served by mainstream financial services providers.

The following are the some of leading microfinance institutions in India working in the sector:

• Association for Sarva Seva Farms (ASSEFA)
• Ujjivan Microfinance
• Bandhan Microfinance
• Mitrabharati - The Indian Microfinance Information Hub Mysore Resettlement and Development Agency (MYRADA)
• SADHAN - The Association of Community Development Finance Institutions
• SEWA- Self-help Women’s Association
• SKS India - Swayam Krishi Sangam
• Streedhan - Banking with Rural Women
• Working Women's Forum, Madras, India

The goals are

• Eradicate Extreme Poverty & Hunger.
• Achieve Universal Education.
• Promote Gender Equality & Women’s Empowerment.
• Reduce Child Mortality
• Combat Diseases
• Developing Entrepreneurial Spirit

TOP 50 MICRO FINANCE INSTITUTIONS OF THE WORLD

Microfinance has assumed immense importance throughout the world in view of its efficacy in credit dispensation, loan repayment and reduction of poverty. The experience world over has proved that hassle free and repetitive dose of credit is the basic need of the poor which has become the hallmark of microfinance. Several countries like Bangladesh, Indonesia, Philippines, Kenya and Bolivia have implemented microfinance programmes with encouraging results. However, the Bangladesh Grameen Bank model under the guidance of Nobel laureate Prof. Mohd. Yunus, is unique because of its remarkable success. The Micro-Finance sector in the world has helped a lot in eradicating poverty from the world. Through the use of Micro-Finance both the living standard and availability of credit to the poor has increased. Forbes’ World Top 50 Micro Finance institutions have been taken from a total number of 641 micro-credit providers. The list is made by the Micro Finance Information Exchange.
<table>
<thead>
<tr>
<th>Rank</th>
<th>Name of Micro Finance Institutions</th>
<th>Country</th>
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<tbody>
<tr>
<td>1</td>
<td>ASA</td>
<td>Bangladesh</td>
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<td>2</td>
<td>Bandhan</td>
<td>India</td>
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<td>3</td>
<td>Banco do Nordeste</td>
<td>Brazil</td>
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<td>4</td>
<td>Fundacion Mundial de la Mujer Bucaramanga</td>
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<td>5</td>
<td>FONDEP Micro-Crédit</td>
<td>Morocco</td>
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<td>6</td>
<td>Amhara Credit and Savings Institution</td>
<td>Ethiopia</td>
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<td>7</td>
<td>Banco Compartamos, S.A., Institución de Banca Múltiple</td>
<td>Mexico</td>
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<td>8</td>
<td>Association Al Amana for the Promotion of Micro-Enterprises</td>
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<td>9</td>
<td>Fundación Mundo Mujer Popayán</td>
<td>Colombia</td>
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<td>10</td>
<td>Fundación WWB Colombia - Cali</td>
<td>Colombia</td>
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<td>11</td>
<td>Consumer Credit Union 'Economic Partnership'</td>
<td>Russia</td>
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<td>12</td>
<td>Fondation Banque Populaire pour le Micro-Credit</td>
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<td>13</td>
<td>Microcredit Foundation of India</td>
<td>India</td>
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<td>14</td>
<td>EKI</td>
<td>Bosnia &amp; Herzegovina</td>
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<td>15</td>
<td>Saadhana Microfin Society</td>
<td>India</td>
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<td>16</td>
<td>Jagorani Chakra Foundation</td>
<td>Bangladesh</td>
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<td>17</td>
<td>Grameen Bank</td>
<td>Bangladesh</td>
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<td>18</td>
<td>Partner</td>
<td>Bosnia &amp; Herzegovina</td>
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<td>19</td>
<td>Grameen Koota</td>
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<td>20</td>
<td>Caja Municipal de Ahorroy Crédito de Cusco</td>
<td>Peru</td>
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<td>21</td>
<td>Bangladesh Rural Advancement Committee</td>
<td>Bangladesh</td>
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<td>22</td>
<td>AgroInvest</td>
<td>Serbia</td>
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<td>23</td>
<td>Caja Municipal de Ahorroy y Crédito de Trujillo</td>
<td>Peru</td>
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<td>23</td>
<td>Sharada's Women's Association for Weaker Section</td>
<td>India</td>
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<td>24</td>
<td>MIKROFIN Banja Luka</td>
<td>Bosnia &amp; Herzegovina</td>
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<td>25</td>
<td>Khan Bank (Agricultural Bank of Mongolia LLP)</td>
<td>Mongolia</td>
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<td>26</td>
<td>INECO Bank</td>
<td>Armenia</td>
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<td>27</td>
<td>Fondation Zakoura</td>
<td>Morocco</td>
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<td>28</td>
<td>Dakahlia Businessmen's Association for Community Development</td>
<td>Egypt</td>
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<td>29</td>
<td>Asmitha Microfin Ltd.</td>
<td>India</td>
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<td>No.</td>
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<td>30</td>
<td>Credi Fe Desarrollo Microempresarial S.A.</td>
<td>Ecuador</td>
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<td>31</td>
<td>Dedebit Credit and Savings Institution</td>
<td>Ethiopia</td>
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<td>32</td>
<td>MI-BOSPO Tuzla</td>
<td>Bosnia &amp; Herzegovina</td>
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<td>33</td>
<td>Fundacion Para La Promocion y el Desarrollo</td>
<td>Nicaragua</td>
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<td>34</td>
<td>Kashf Foundation</td>
<td>Pakistan</td>
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<td>35</td>
<td>Shakti Foundation for Disadvantaged Women</td>
<td>Bangladesh</td>
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<td>36</td>
<td>Enda inter-arabe</td>
<td>Tunisia</td>
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<td>37</td>
<td>Kazakhstan Loan Fund</td>
<td>Kazakhstan</td>
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<td>38</td>
<td>Integrated Development Foundation</td>
<td>Bangladesh</td>
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<td>39</td>
<td>Microcredit Organization Sunrise</td>
<td>Bosnia &amp; Herzegovina</td>
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<td>40</td>
<td>FINCA - ECU</td>
<td>Ecuador</td>
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<td>41</td>
<td>Caja Municipal de Ahorro y Crédito de Arequipa</td>
<td>Peru</td>
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<td>42</td>
<td>Crédito con Educación Rural</td>
<td>Bolivia</td>
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<td>43</td>
<td>BESA Fund</td>
<td>Albania</td>
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<td>44</td>
<td>SKS Microfinance Private Limited</td>
<td>India</td>
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<td>45</td>
<td>Development and Employment Fund</td>
<td>Jordon</td>
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<td>46</td>
<td>Programas para la Mujer - Peru</td>
<td>Peru</td>
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<td>47</td>
<td>Kreditimi Rural i Kosoves LLC (formerly Rural Finance Project of Kosovo)</td>
<td>Kosovo</td>
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<td>48</td>
<td>BURO, formerly BURO Tangail</td>
<td>Bangladesh</td>
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<td>49</td>
<td>Opportunity Bank A.D. Podgorica</td>
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<td>50</td>
<td>Sanasa Development Bank</td>
<td>Sri Lanka</td>
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**IS MICRO FINANCING SUCCESSFUL IN INDIA?**

Microfinance has no doubt improved the lives of the poor in India but sometimes it leads people to borrow too much, to the extent that over indebtedness can lead to suicides in extreme cases. Microfinance does not directly address some structural problems facing Indian society and the economy, and it is not yet as efficient as it will be when economies of scale are realised and a more supportive policy environment is created. Loan products are still too inflexible, and savings and insurance services that the poor also need are not widely available due to regulatory barriers. Insufficient data exists on client-level impact, though new tools such as the Poverty Progress Index of Grameen Foundation and the work of Sa-Dhan (the association of Indian MFIs) on measuring client satisfaction are addressing this gap. The high interest rates and forced loan recovery practices of micro-finance institutions have been held responsible for the suicide of several farmers in Andhra Pradesh. It is evident that poverty makes good business sense to MFIs. The erring Micro-Finance Institutions (MFIs) have been charged with exploiting the poor with ‘usurious interest rates’ and intimidating the borrowers by ‘forced loan recovery’ practices, the combined effect of which forced the debt-ridden poor to suicide.
MICRO FINANCE AS A TOOL FOR FINANCIAL INCLUSION

Indian microfinance has continued growing rapidly towards the main objective of financial inclusion, extending outreach to a growing share of poor households and to the approximately 80 per cent of the population, which has yet to be reached directly by the banks. Micro finance is the new fad in the Indian financial system. It is growing rapidly and getting a lot of attention from financial institutions, non-governmental organisations (NGOs) and the Government, as an instrument of financial inclusion that can transform the lives of the poor. A vibrant and developed micro-finance sector can significantly impact economic development and distribution of wealth.

MICRO FINANCE AS A TOOL FOR POVERTY REDUCTION

Microfinance has attracted considerable attention as a suitable poverty reduction strategy given its potential to increase the physical capital of the poor while simultaneously building human and social capital. Micro credit must reach the poor, building their capacity to absorb higher credit, and also ensure greater availability of credit for small enterprises, said Indian Prime Minister Manmohan Singh, announcing the government's intention to introduce legislation that would create a friendly policy environment for microfinance services.

Twentieth century witnessed large-scale conscious efforts at social change to improve the quality of life of the disadvantaged. The concept of microfinance emerged from the experiences of these efforts. It was recognised that making financial services available to the poor is a necessary, though not sufficient, condition for improving the quality of their life. However, it was also observed that in spite of a large established network of financial outlets, a sizeable majority of the disadvantaged had no access to formal financial systems.

Therefore, development thinkers in different parts of the world made efforts to make financial services, including savings and credit, available to the disadvantaged. Poverty reduction involves the transfer to and building up of essential human, social, and physical capital for the poor. Microfinance has attracted considerable attention as a suitable intervention given its potential to increase the physical capital of the poor while simultaneously building human and social capital. Some innovative efforts in India and Bangladesh demonstrated that it was possible to extend financial services to the poor, if:

- Banking is made easy for them, with simplified procedures
- Transaction costs are reduced for both the borrower and the lender
- The person is financed, not the project
- Peers in the community are involved in appraisal and follow-ups
- Repayments are designed to fit the cash-flows of the borrower
- Small sums are collected at regular intervals instead of lump-sum payments

THE GRAMEEN BANK, BANGLADESH – INNOVATOR OF MICRO FINANCE

The idea for the Grameen Bank did not come down from the academy, or from ideas that started in high-income countries and then spread broadly. Programs that have been set up in North Carolina, New York City, Chicago, Boston, and Washington, D.C. cite Grameen as an inspiration. In addition, Grameen’s group lending model has been replicated in Bolivia, Chile, China, Ethiopia, Honduras, India, Malaysia, Mali, the Philippines, Sri Lanka, Tanzania, Thailand, the U.S., and Vietnam. When Bill Clinton was still governor, it was Mohd Yunus, founder of the Grameen Bank (and a Vanderbilt-trained economist), who was called on to help set up the Good Faith Fund in Arkansas, one of the early microfinance organizations in the U.S. Mohd Yunus found that most villagers were unable to obtain credit at reasonable rates, so he began by lending them money from his own pocket, allowing the villagers to buy materials for projects like weaving bamboo stools and making pots. Ten years later, Mohd Yunus had set up the bank, drawing on lessons from informal financial institutions to lend exclusively to groups of poor households. Common loan uses include rice processing, livestock raising, and traditional crafts. The groups form voluntarily, and, while loans are made to individuals, all in the group are held responsible for loan repayment. The groups consist of five borrowers each, with lending first to two, then to the next two, and then to the fifth. These groups of five meet together weekly with seven other groups, so that bank staff meets with forty clients at a time. According to the rules, if one member ever defaults, all in the group are denied subsequent loans. The contracts take advantage of local information and the
NABARD envisages reaching banking services to self-employment scheme, namely, SGSY, the credit reach for the million poor in India through the Budget. While the GOI tries to widen the micro-sector lending.

The Reserve Bank of India (RBI) in 1996 included financing to SHGs as a mainstream activity of banks under their priority sector lending. The Government bestowed national priority to the programme through its recognition in the 1999 budget. While the GOI tries to widen the micro-credit reach for the million poor in India through the self-employment scheme, namely, SGSY, the NABARD envisages reaching banking services to one-third of the very poor in India, that is, a population of about 100 million rural poor through one million SHGs by 2007-08.

As part of the poverty alleviation measures, the Government of India (GOI) launched the Swarnjayanti Gram Swarojgar Yojana (SGSY) in 1999 where the major emphasis is on self-help group (SHG) formation, social mobilisation and economic activation through micro-credit finance. Up to March 2003, 13.38 lakh groups were constituted in 33 States and Union Territories, of which 33,436 SHGs only could take up economic activities for their economic sustenance. Simultaneously, the Government supports the NABARD to take up activities such as group formation, micro-finance and economic activation.

Besides this, the Rashtriya Mahila Kosh (National Credit Fund for Women) and the Department of Women and Child Development have their own programmes under which micro credit is being provided for economic empowerment of the rural poor.

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GOVERNMENT INITIATIVES FOR PROMOTION OF MICRO FINANCE TO ALLEVIATE POVERTY

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ROADBLOCKS FOR MICRO FINANCE

As part of this growth stage, microfinance in India is undergoing rapid changes and discovering new challenges. Collecting money from scattered, remote clients, the cost of service delivery transactions in the “last mile”, effective information exchange at the institutional level, and effective growth management are just a few of the many challenges confronting MFI.

- Time Consuming: Generally a borrower repaid the loan weekly and so for an annual loan of Rs 5000, a collection officer had to visit 52 times, pushing up the transaction cost per loan.
- Regulatory Hurdles: The microfinance industry faces huge regulatory hurdles in raising finances. It has limited access to foreign capital, either as equity or even as borrowings. It has to rely largely on bank financing (loans to MFI, fortunately, qualify for priority sector lending). This has other associated cost-related problems. Most microfinance companies in the country today borrow at 11%-12% from banks. Transaction costs add another 10%-11%. Add another 2% as normal margin, cushion for debt defaults and capital adequacy and the rate works out to 23%-24%.
- Non-Productive Loans And Procedural Delays For Productive Loans: Since most of the poor and needy are illiterate and prefer loans for consumption rather than productive purposes, majority of the poor find it hard to get loans
sanctioned for taking up economic activities, even if they want to. Sometimes, the loanees are asked to furnish some documents and collateral security against the loan sanctioned, contrary to the directives of the Government and the RBI.

- **Financial Viability:** MFIs operating on small-scale face financial problems. Meeting administrative overheads and generating surpluses for expansion out of the spread between their interest income and the interest they pay on the bank finance may become difficult. The average borrowing costs of MFIs have increased from 10.5% in 2001-02 to 12% in 2004-05. High borrowing costs coupled with high operating expenses ranging between 4 to 19 per cent impede MFIs ability to offer competitive rates to the customer-beneficiaries. As against this, public sector banks lend directly to SHGs at interest rates varying between 9 to 12 per cent.

- **Capacity Building of the SHGs:** Training and strengthening the groups, improving their accounting, increasing their monthly savings to enable them to avail of larger loans in successive rounds of borrowing, providing marketing facilities and infrastructural facilities to the products that they manufacture are huge challenges before the MFIs.

- **Inflexibility and Delay:** The rigid systems and procedures for sanctioning loans and disbursing them to the beneficiaries result in a lot of delay in time for the borrowers, which de-motivate them.

- **High Interest Rates:** Comparatively higher interest rate (12-36 per cent per annum) charged by the MFIs has again become a contentious issue. Sometimes, a few financial institutions charge the beneficiaries of a group high interest rate which makes the repayment difficult for the very poor. The poorest of the poor are, therefore, unable to access the micro-finance benefits. The high interest rate collected by the MFIs from their poor clients is still perceived as exploitative in some quarters. Rate of interest has to be reduced.

- **High Transaction Costs:** Although the interest rate offered to the borrowers is regulated, the transaction costs in terms of the number of trips to be made, the documents to be furnished etc. plus the illegal charges demanded by the lending institutions clandestinely, result in increasing the cost of borrowing, thus, making it less attractive to the borrowers.

- **Lack of Trained Staff:** One of the biggest challenges in urban micro-finance may well be recruiting people with the right service orientation. The salesmen need to be able to relate to the people they lend to and not be seen as condescending. The typical urban salesman who likes to be seen with the latest cell phone model definitely does not fit into this mould.

- **Social Obligation, Not a Business Opportunity:** Micro-finance has been seen as a social obligation rather than a potential business opportunity.

- **Capital Funds:** MFIs growth is constrained by the capacity of their staff and the availability of capital funds. Indian MFIs are depending on donor funds.

- **Lack of Training:** In most of the cases, it has been found that members of a group take up certain economic activities for their sustenance which are not preceded by relevant training. After the pioneering efforts of the last few years by the government, banks, NGOs, and so on, the micro-finance scene is reaching the take-off point.

### ATTEMPTS OF SELECTED ORGANISATIONS TOWARDS MICRO FINANCE

- **OB Grameen Project of Oriental Bank of Commerce:** Oriental Bank of Commerce (OBC) was one of the first Commercial Banks to pioneer micro finance under their ‘OB Grameen Project’ in Uttaranchal and Rajasthan. A unique feature of this initiative was that unlike the SHG-Bank Linkage model where the SHG or its representatives come to the bank branch to transact, in the OBC model the bank officials go to the groups on pre-determined dates. This by itself was a revolutionary step. The experiment needs to be assessed further and lessons drawn from it.

- **Airtel Ties Up With SKS Micro Finance:** Efforts As part of its Grameen Mobile Kranti, Bharti Airtel has entered into a strategic tie-up with SKS Microfinance. The initiative is aimed at offering mobile handsets bundled with prepaid connections to SKS' members. While Airtel will provide free prepaid SIM cards to the SKS members, the microfinance company has tied up with Nokia for handsets and would be providing loans to members to purchase the handsets.

- **Citibank Ties Up With SKS Micro Finance** Citibank and SKS Microfinance Pvt Ltd. have tied up to launch a Rs 180-crore programme to extend micro credit in rural areas. As per the tie-up, each individual loan generated by SKS would be purchased by Citibank, which shares credit risk in the transaction. This is the single largest investment in micro finance by a global player. The programme...
would deliver loans ranging from Rs 5,000 to Rs 20,000 in over 7,000 un-banked villages in the country where SKS is present through its 49 branches. The origination and servicing of loans would rest with SKS while Citibank would extend the funds and would have it reflected in its balance sheet.

- **ABN AMRO Bank Offers Microfinance In India, To Fulfill Its Mission Of Sustainable Development:** The bank believes microfinance is a very powerful tool that can be used effectively to address poverty, empower the socially marginalized poor and strengthen the social fabric. Especially when directed at women, the benefits of microfinance multiply many folds. Through microfinance, the bank believes that it can enhance human as well as financial capital for the future and leave behind a better world for the children. The microfinance program of the bank is aimed at delivering credit to the target community, through Microfinance Institutions (MFIs). The target community is the poor women of India, especially in the rural areas. The products offered to the MFIs are term loans of varying tenors, structured suitably to match the specific needs of the individual MFI at a commercial, competitive rate of interest.

- **ICICI Bank Ties Up With Micro Credit Foundation:** Under the arrangement, MFI would facilitate formation of self-help groups and help them acquire capability to generate income for the group. Later, MFI would provide finance for the income generating activities. In all these areas, ICICI Bank would back MFI with the funds needed.

- **Fullerton India to support ‘Srijan Microfinance Business Plan Competition 2008’:** India’s only microfinance business plan competition - Srijan 2008 received strategic tie-up with Fullerton India Credit Company Limited. Confirming their involvement as part of their Corporate Social Responsibility (CSR) in Srijan 2008 as Associate Sponsors, Fullerton India not only announced a financial contribution but also promised a long-term commitment to providing Mentor Capital to the most promising business ideas, arising out of the this national-level entrepreneurship platform. Organized annually by Intellecap, Srijan this year is co-organized by Aavishkaar Goodwill and The Financial Express. The competition seeks to address three priority areas for the microfinance sector: lack of risk capital, knowledge asymmetry, and application of technological innovation for business efficiency. Most importantly, the competition brings in the much needed ‘Mentor Capital’ to entrepreneurs and recognizes those capable of building institutions to accelerate microfinance delivery to the poor. As a platform, Srijan helps investors and ideas work together towards creating the desired multiple bottom line impact. As an integral part of this support, Fullerton India will sponsor part of the operational costs associated with the event. It will also involve its senior staff as Screeners, Judges and shall provide mentoring support to the top Srijan entrepreneurs.

**CONCLUSION**

Urban poverty is as much a reality as rural poverty. Microfinance is an effective tool in poverty alleviation and there is an urgent need for proliferation of this tool in a systematic and steady pace even in the urban areas, so that there can be more inclusive growth across all parts of the country. In their efforts to alleviate poverty, the pioneers of modern micro finance made a remarkable discovery – the poor could serve as reliable borrowers – and developed this insight into a worldwide industry capable of leveraging the commercial capital markets to deliver financial services to millions of poor. As MFIs attempt to reach ever more of the world’s poor, the role of commercialization is being widely debated. Critics of increasing commercialization propose a hybrid alternative combining non-profit and for-profit models. Advocates of this approach call for MFIs to return profits back to the poor in the form of lower rates. The 2006 Nobel laureate Mohammad Yunus, widely recognised as the founding father of modern micro finance, is perhaps the most prominent opponent of the idea of profits in micro finance.

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