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Seema Sangwan
Department Of Management, Assistant Professor, UILMS Gurgaon, India.

Micro finance: Challenges and Contribution in poverty alleviation

Seema Sangwan

Abstract
The term micro finance sometimes is used interchangeably with the term micro credit. Micro finance is a broad term that includes deposits, loans, payment services and insurances to poor. Through this paper researcher intends to cover that microfinance is not to just distribute the credit to poor’s but also help them to raise their standard of living by earning through tiny and small business setting up by microcredit. Studies show that these mandatory and dedicated subsidized financial programmes have been implemented through banking institutions but unable to meet their social and economic objectives. There are several key issues in Microfinance in India which I would like to cover through this paper. Financial inclusion is a great step to alleviate poverty in India, thus government should provide such an environment in which banks will freely pursue the necessary innovations to reach the low income consumers and still make profit. To achieve their target, a new policy initiative needs to be taken by the Government for the smooth implementation of this concept.

Keywords: Micro finance, Challenges, Contribution, poverty alleviation

Introduction
Microfinance sector has traversed a long journey from micro savings to micro credit and then to micro enterprises and now entered the field of micro insurance, micro remittance and micro pension. However while micro credit refers to purveyance of loans in small quantities, the term microfinance has a broader meaning covering in its ambit other financial services like saving, insurance etc. as well. The proposed Microfinance Services Regulation Bill defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for : i. 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 ii. an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing purposes, or iii. Such other amounts, for any of the purposes mentioned at items (i) and (ii) above or other purposes, as may be prescribed.”
The concept of micro finance and micro credit are used interchangeably. But micro credit does not include savings; hence micro finance is more appropriate term (Manimekalai, 2004) Microfinance is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services Micro-finance could be defined as a set of services comprising the following activities: Micro – Credit: Small loans; primarily for income generation activities, but also for consumption and contingency needs and Micro – saving: thrift or small savings from borrowers ‘own resources and Micro –insurance and fund transfers.

Evolution of microfinance and its progress in India
In his book, *Banker to the poor: Micro lending and the battle against world poverty* (1999), Dr. Mohammad Yunus describes the evolution of Grameen Bank. Recognizing the limitations of his personal loans to impact poverty on a larger scale, he approached commercial banks with the idea to provide credit to the poor, backed with evidence from his pilot study. He claimed that people are not poor because of personal dispositions toward laziness or lack of intelligence; rather people are in impoverished situations because of their

Correspondence:
Seema Sangwan
Department Of Management, Assistant Professor, UILMS Gurgaon, India.

limited access to economic resources, including credit. After exhausting the existing possibilities in the formal financial sector, he decided to open his own bank. Dr. Mohammad Yunus founded Grameen bank in 1976. It is the pioneer of the contemporary version of *banking for the poor* (Yunus, 1999) [14], and it remains one of the largest microfinance institutions (MFIs) in the world. Globally, over a billion poor people are still without access to formal financial services and some 200 million of them live in India. Since independence the formal banking institutions have had ignored the poor due to perceived high risks, high transaction costs involved in small-scale rural lending to a large number of poor households and absence of collateral securities. Since 2006-07, NABARD has been compiling and analyzing the data on progress made in microfinance sector, based on the returns furnished by Commercial Banks (CBs), Regional Rural Banks (RRBs) and Cooperative Banks operating in the country. The banks operating, presently, in the formal financial system comprise Public Sector CBs (27), Private Sectors (22), RRBs (82), State Cooperative Banks (31) and District Central Cooperative Banks (370).

Objectives: To study how microfinance schemes supports low incomes groups and the various channels of micro finance in India. To know how microfinance contributes to economic development and the key issues in Microfinance in India.

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

SHG model – How it works and institutions 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:

Progress under Microfinance

Table : 1- Overall Progress under Micro-finance during the last three years

(₹ in crore)

Particulars		2007-08		2008-09		% Growth (2008-09)		2009-10		% Growth (2009-10)	
		No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount
A. SHG-Bank Linkage Model											
Savings of SHGs with Bank as on 31 March	Total SHGs	5009794	3785.39	6121147	5545.62	22.2	46.5	6953250	6198.71	13.6	11.8
	Out of which SGSY	1203070	809.51	1505581	1563.38	25.1	93.1	1693910	1292.62	12.5	(17.3)
Bank Loans disbursed to SHGs during the year	Total SHGs	1227770	8849.26	1609586	12253.51	31.1	38.5	1586822	14453.30	(1.4)	17.9
	Out of which SGSY	246649	1857.74	264653	2015.22	7.3	8.5	267403	2198.00	1.0	9.1
Bank Loans outstanding with SHGs as on 31 March	Total SHGs	3625941	16999.91	4224338	22679.84	16.5	33.4	4851356	28038.28	14.8	23.6
	Out of which SGSY	916978	4816.87	976887	5861.72	6.5	21.7	1245394	6251.08	27.5	6.6

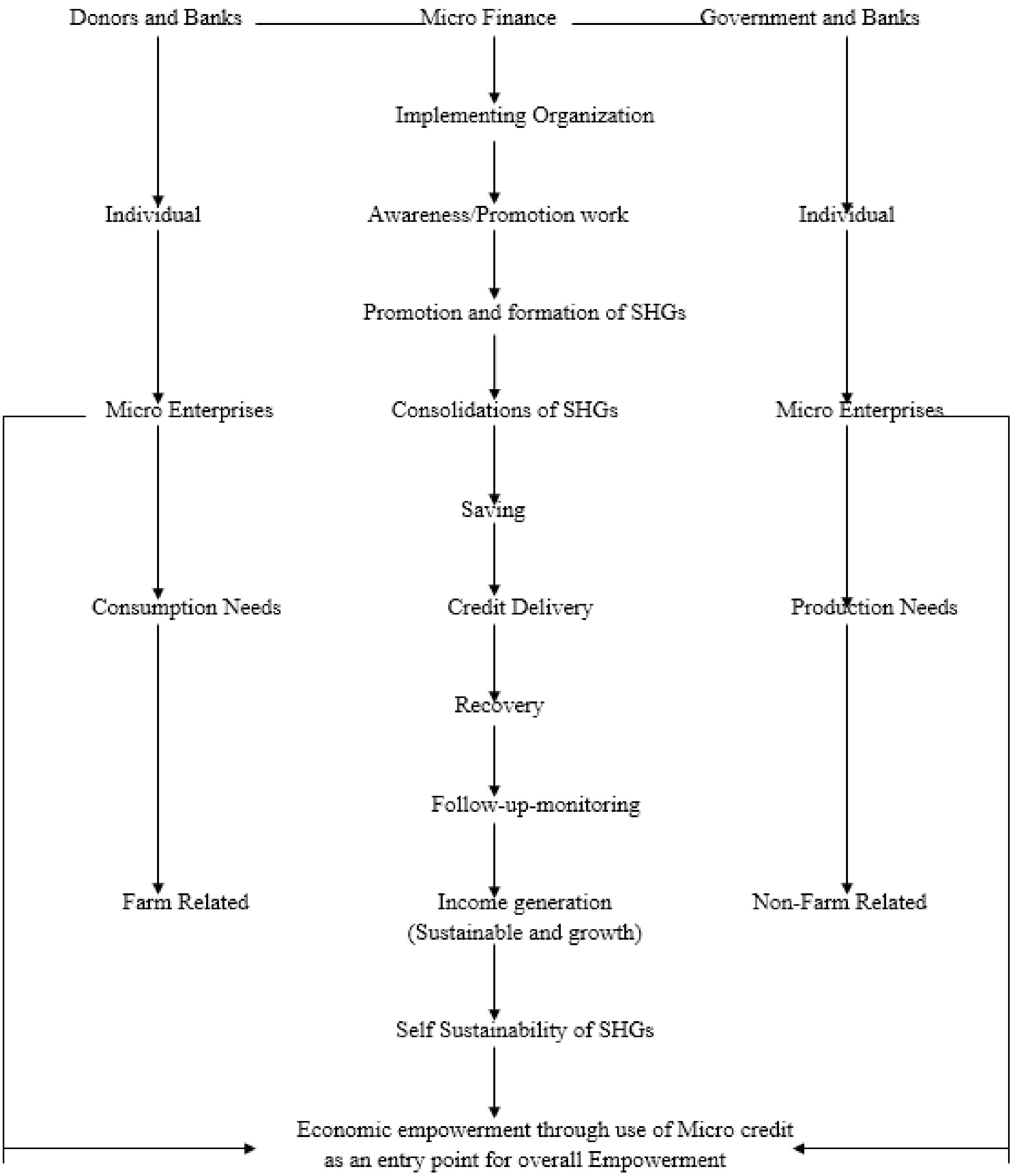
B.(1) MFI-Bank Linkage Model (₹ in crore)

Particulars	2007-08		2008-09		Growth during 2008-09 (%)		2009-10		Growth during 2009-10 (%)	
	No. of MFIs	Amount	No. of MFIs	Amount	No. of MFIs	Amount	No. of MFIs	Amount	No. of MFIs	Amount
Bank Loans disbursed to MFIs during the year	518	1970.15	581	3732.33	12.2%	89.4%	691	8062.74	18.9%	116.0%
Bank Loans outstanding with MFIs as on 31 March	1109	2748.84	1915	5009.09	72.7%	82.2%	1513	10147.54	(21%)	102.6%

Note : Actual number of MFIs provided with bank loans would be less as several MFIs could have availed loans from more than one bank.

Microfinance as a part of financial inclusion
The Nationalization of commercial banks in July 1969 and measures of branch expansion and priority sector lending resulted in the introduction of a new concept of Financial Inclusion by RBI and Government of India. This concept is concerned with the delivery of financial services at affordable cost to the disadvantaged and low income segments of the society as well as protects them from the hands of exploiting informal sources of finance by facilitating them with financial resources. In spite of all the measures taken by RBI, a major chunk of the population remains financially excluded and deprived of these facilities. The present scenario shows mixed results. Since 2005, the RBI has disseminated a drive for Financial Inclusion, where banks will promote the participation of every household at district level via savings account for the 'unbanked'. The opening of the "No Frill Account" is the fast emerging policy initiative. Financial inclusion is a great step to alleviate poverty in India. The government should provide such an environment in which banks will freely pursue the necessary innovations to reach the low income consumers and still make profit. Thus to achieve this, a new policy initiative needs to be taken by the Government for the smooth implementation of this concept.

Development Process through Micro Finance



Challenges

Debt Management: Clients are uneducated about debt management 70% of the clients in MFIs are unaware of the fact that how to manage their debt. Because of the lack of education and understanding on the part of the clients, they also cannot correctly manage the loans given to them. Loan Default: Loan default is an issue that creates a problem in growth and expansion of the organization because around 73% loan default is identified in MFIs. Low Education Level: The level of education of the clients is low. So it creates a problem in the growth and expansion of the organization because its percentage is around 70% in MFIs. High Transaction Cost: High transaction cost is a big challenge for microfinance institution. The volume of transactions is very small, whereas the fixed cost of those transactions is very high. It cannot vary with the size of the loan. Language Barrier: Language barrier makes communication with the clients (verbal and written) is an issue that creates a problem in growth and expansion of the organization. Fraud: Fraud is an issue that creates a problem in growth and expansion of the organization because its percentage is around 67% in MFIs. Deserving Poor are still not Reached and Quality of SHGs: The third challenge is how to ensure quality of MFIs in an environment of exponential growth. Late Payments: Late payments are an issue that creates a problem in growth and expansion of the organization because late payments are around 70% in MFIs. Unregulated Microfinance Institutions: In India, microfinance is provided by a variety of institutions. These include banks (including commercial banks, RRBs and co-operative banks), primary agricultural credit societies and MFIs that include NBFCs, Section-25 companies, trusts and societies. But only the banks and NBFCs under the regulatory purview of the Reserve Bank of India.

Recommendations

Proper Regulation: The regulation was not a major concern when the microfinance was in its nascent stage and individual institutions were free to bring in innovative operational models. Field Supervision: In addition to proper regulation of the microfinance sector, field visits can be adopted as a medium for monitoring the conditions on ground and initiating corrective action if needed. This will keep a check on the performance of ground staff of various MFIs and their recovery practices. This will also encourage MFIs to abide by proper code of conduct and work more efficiently. Encourage rural penetration: It has been seen that in lieu of reducing the initial cost, MFIs are opening their branches in places which already have a few MFIs operating. Complete range of Products: MFIs should provide complete range of products including credit, savings, remittance, financial advice and also non-financial services like training and support. As MFIs are acting as a substitute to banks in areas where people don’t have access to banks, providing a complete range of products will enable the poor to avail all services. Transparency of Interest rates: As it has been observed that, MFIs are employing different patterns of charging interest rates and a few are also charging additional charges and interest free deposits (a part of the loan amount is kept as deposit on which no interest is paid).

Conclusion: Highlighting the importance of microfinance plays a crucial role in building confidence and improvement in small saving. The performance of SHG program can be improved by proper state administration. NGOs are not substitute of government authorities and responsibility but they can coordinate the microfinance scheme with government. Micro finance can contribute to solving the problems of inadequate housing and urban services as an integral part of poverty alleviation programmes. Polices could be more appropriately designed if they took into consideration the differential impact of micro-finance on women and men. Microfinance programmes have significant potential for contributing to women’s economic, social and political empowerment. Several programmes have been developed for upliftment of backward areas such as Milaap, that aims at providing sanitation and water facilities to the poor people.

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