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GRT Golden Research Thoughts

ROLE OF MICROFINANCE IN SOCIO ECONOMIC DEVELOPMENT

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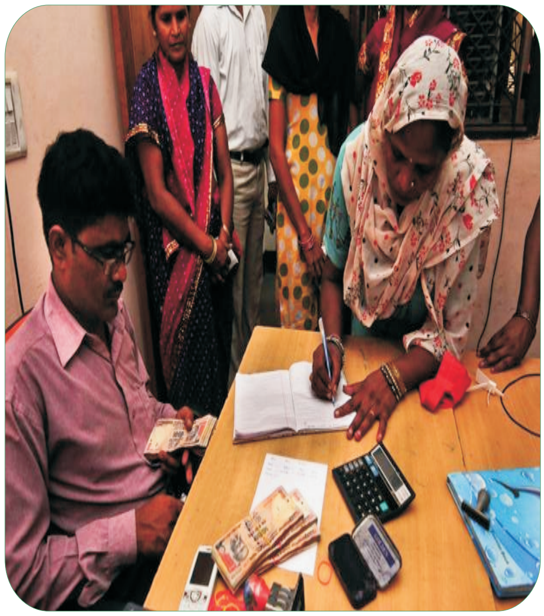

ABSTRACT

Poverty is an evil. It's the creator of many socio-economic problems. Eradicating world poverty is the greatest challenge of our time, and the greatest weapon for fighting poverty is ready availability of resources and empowering the poor with livelihood, employment and self-employment. India is said to be home of one third of world's poor and it is shocking but factual that large percentage of the poorest households do not have access to the credit. A nation can be socially and economically strong only if none of their citizens are without work and basic necessities.

KEYWORDS :*Socio Economic Development , Poverty , self-employment.*

1.INTRODUCTION

Most developing countries including India from 1950s to the 1980s were home to interventions ranging from establishing state owned financial institutions, interest rate ceiling on deposits and credit, credit subsidy, directing credit to particular sectors and nationalization of private banks. This 'supply led' approach in rural finance caused various qualitative issues such as concerns about financial viability of institutions on account of high rate of loan delinquency, concerning of subsidy by well off people, continuous presence of moneylenders, inability to reach the core poor. All this led to a reorientation in thinking around 1980s.

All the above problems and deficiencies in the approach of countries from 1950s to 1980s led to paradigm shift and also led to the emergence of micro credit in late 1970s and early 1980s. This new paradigm of unsecured small scale financial service provision helped poor people take advantage of economic opportunities, expand their income, smoothen their consumption requirement and reduce vulnerability, thus empowering them. Realizing the importance of microfinance, World Bank and other major global financial institutions have also taken major steps in developing the sector. Other Regional multilateral development banks like Asian Development Bank also championed the cause of commercial microfinance.

Increasing access to credit for the poor has always remained at the core of Indian planning in fight against poverty. The assumption behind expanding outreach of financial services, mainly credit was that the welfare costs of exclusion from the banking sector, especially for rural poor are very high. Starting late 1960s, India was home to one of largest state intervention in rural credit market. Lots of development took place in extending the rural credit through nationalization of existing private commercial banks, massive expansion of branch network in rural areas of interest and creation of a new set of rural banks at district level and an apex bank for agriculture and rural development, Viz. National Bank for Agriculture and Rural Development (NABARD), at national level. These measures resulted in impressive gains in rural outreach and volume of credit. As a result, between 1961 and 2000 the average population per bank branch fell tenfold from about 140 thousand to 14000 (Burgess & Pande, 2005) and the share of institutional agencies in rural credit increased from 7.3% 1951 to 66% in 1991. These impressive gains were not without a cost. Government interventions through directed credit, state owned Rural Financial Institutions (RFI) and subsidized interest rates increased the tolerance for loan defaults, loan waivers and tax appraisal and monitoring of loans. Successful microfinance interventions across the world especially in Asia and in parts of India by NGOs provided further impetus.

It was realized that the poor tended to come together in a variety of informal ways for pooling their savings and dispensing small and unsecured loans at varying costs to group members on the basis of need. This concept of Self-help was discovered by social-development NGOs in 1980s. Realizing that the only constraining factor in unleashing the potential of these groups was scantiness of their financial resources, NABARD designed the concept of linking these groups with banks to overcome the financial constraint and today this programme has emerged as the world's biggest microfinance programme in terms of outreach, covering 1.6 million groups as on March, 2005. It occupies a pre-eminent position in the sector accounting for nearly 80% market share in India.

2. MICRO-FINANCE AND SOCIO ECONOMIC DEVELOPMENT:

Post liberalization of Indian economy in the early 1990s, India has taken huge strides in economic development. However, many studies show that large section of society has not been able to enjoy the fruits of this prosperity. It is important to examine changes in the human development index over time to understand not so strong percolation of fruits to certain section of society since it provides a composite measure of three dimensions of human development: living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and gross enrolment in education) and having a decent standard of living (measured by purchasing power parity, PPP, income). The human development index trends tell an important story in that respect. Between 1980 and 2007 India's HDI rose by 1.33% annually from 0.427 to 0.612 today. HDI scores in all regions have increased progressively over the years although all have experienced periods of slower growth or even reversals. However, the growth is still very slow. According to 2002 Human Development Index (HDI) indicators, India was ranked 103rd, behind even countries like Mongolia and Gabon. Despite all its economic progress, India today as per 2007 HDI indicators is ranked at 134.

As per Human Poverty Index (HPI) published for 2007, 28% of India's population is still below poverty line. India is ranked 88th among 135 countries for which this Index was calculated. HPI focuses on the proportion of people below certain threshold levels in each of the dimensions of the human development index- living a long and healthy life, having access to education, and a decent standard of living.

India even after liberalization of the economy still has high illiteracy rate, large population still under poverty line, environmental degradation, inadequate health services in rural areas and an irregular or a complete lack of potable water and sanitation in a number of areas. There are various reasons for such shortcomings, such as traditional class, caste and gender hierarchies, lack of awareness, politics that focus solely on vote banks and does little for development, and inefficiency and corruption at bureaucrat levels. Many NGOs are working with the marginalized communities improving their living conditions, giving them education and vocational training and providing them with financial assistance.

Simanowitz & Walter (2002) have correctly observed that "Microfinance is a compromise between social and financial objectives. To date most emphasis has been on financial and institutional performance".

The rural finance policy pursued in most developing countries beginning form 1950s was based on providing subsidized credit through state controlled or directed institutions to rural segments of population. A major constraint to the participation and contribution of poor and vulnerable households in economic growth is access to financial credit. Access to financial services permits individuals and households to better manage the risks and uncertainties they face such as to save in secure ways, to invest in a business or home, or to cope with or insure against unexpected shocks.

The key problem areas visualized in rural financial markets included a lack of credit in rural areas, absence of modern technology in agriculture, low savings capacity in rural areas and prevalence of usurious moneylenders. Formal financial intermediaries such as commercial banks often do not serve poor households for reasons that include the lack of traditional collateral, high costs of small transactions, inferiority complex among poor, illiteracy, ignorant to banking and geographic isolation. Poor households' access to financial services is generally limited to informal transfers or loans, individually or through savings clubs, rotating savings and credit associations, and mutual insurance societies.

Thus, the micro-finance becomes one of the very important tools for extending credits to rural sector and poor households. The institutions that provide micro-finance and credit services are diverse, including non-governmental organizations (NGOs), credit unions, non-bank financial intermediaries, and cooperative & commercial banks. The loans and credit extended are typically small ("micro"). They are provided in varying contexts, either to individuals or groups, ranging from personal micro-credit, to small enterprises support and rural finance like agriculture, artisan, vocation etc. Certain degree of poverty entrapment may therefore be inevitable when poor and risk-averse households deliberately shun new or profitable activities in order to contain income risks to some minimum level.

Rural financial markets are important because financial intermediation facilitates general economic growth and poverty reduction. Financial intermediaries mobilize funds, allocate them among competing uses, create money, and function as a payments system. The efficient provision of loan, deposit, payment, and insurance services enables entrepreneurship, innovation, and production to develop and flourish. Safe savings facilities, payment services, access to credit, and reliable insurance mechanisms enable poor households to reduce vulnerability by smoothing consumption and mitigating risks. Because rural income cycles are particularly volatile, financial intermediation is especially important to shift purchasing power over time, as well as between net savers and net investors or spenders at any given time.

Local constraints that can prevent rural financial markets and micro-finance from operating efficiently include:

a) Unsound macroeconomic management.

b) Restrictive agricultural or financial policies (particularly interest rate controls);

c) Insufficient institutional capacity within rural financial institutions to achieve high levels of outreach in a sustainable manner;

d) Underdeveloped legal systems, particularly with respect to marketable property rights, resulting in weak collateralization of claims and inadequate contract enforcement mechanisms;

e) Inadequate prudential regulation and supervision of financial intermediaries; and

f) Poor governance, corruption, and other political factors that raise risks atmosphere of no-trust on leadership in the society.

For the above reasons, most of the financial institutions (such as commercial banks) have largely avoided serving rural areas. At many places, the financial services are provided by only informal agents or mechanisms, which offer a narrow range of financial services to limited customers. Lack of access to financing at reasonable cost leaves most micro entrepreneurs dependent on self-finance or very costly, short term credit and limits their ability to actively benefit from investment opportunities and contribute to growth.

In many cases, concessional or directed credit and bailouts of state-owned agricultural credit institutions have left private, for profit rural financial institutions in lurch. The political weakness of the rural poor and their institutions also contribute to their reliance on informal rather than formal rural financial services. The rural economy is predominantly agriculture based and oriented. So most of the cash inflows for rural individuals are seasonal which is mostly around harvest time. Even non-farm incomes sometimes tend to depend on agricultural income.

Microfinance, micro credit and micro insurance are towers of strength for socio-economic development of an economy. Microfinance enterprises face more problems in raising finance, as the provider of finance may not find the return on investment interesting as compared to large enterprise, and also investor is more skeptical about repayment. The micro financing has blend of social and economic characteristics and hence the foundation needs to be strong that can achieve objectives of micro financing efficiently and effectively, if one knows the pillars of micro financing.

3. CHALLENGES IN MICRO-FINANCE:

Increasingly, the need for broad basing the reach of basic financial service offerings such as credit, savings, money-management and insurance products to the people falling within the low income category brackets in India is being felt. This is area where the formal sector has a bare presence today, is fraught with practical impediments that need to be overcome in order to develop a mechanism for ensuring smooth delivery of such services. Both the government and various non government organization (NG)s) play a very active role in various activities that seek to improve the socio-economic condition of the deprived. Micro-credit and microfinance are such instruments that provide economic assistance for alternative mode of employment and income. Various national and private banks today offer micro-credit to rural communities, especially women, enabling then to empower themselves. However, there are few challenges faced by microfinance enterprises in India.

The following continuing challenges are faced in micro-finance by India and also the international community :

a) Finding ways to build the capacity of the micro finance sector to complement the existing informal and private institutions,

b) Promoting access to the micro-finance markets for the poor and helping to ensure that they are sustainable.

c) Consolidating saving and work skill of poor community with administrative and technical support linked up with financial support by financial institutes.

d) Inability of a large section of the population to pay for the ease of access to such financial service offerings.

e) Inadequacy of risk capital to provide the degree of coverage required to absorb the risks inherent in this business.

f) Non-availability if finance for on-lending to the borrowers even to the extent of the risk capital that already exists

g) Non-availability of long-term finance to pay for creation of necessary infrastructure and pre-operative expenses

h) Inadequacy of well-trained personnel in their rolls
i) Low or negligible access to appropriate technology
j) High cost of service associated with the low-value, high volume and cash intensive nature of the business and the high fixed and variable costs associated with putting in place the physical infrastructures required to broaden the reach
k) Risk management challenges associated with the high levels of information asymmetry, the tenuous nature of the underlying viability of the economic activity for which funding is sought and the high degree of exposure to exogenous shocks.

High levels of poverty combined with slow economic growth in the formal sector have forced a large part of the developing world's population into self-employment and informal activities. Economic development is not percolated to unskilled poor masses uniformly, this have cascading effect in turn. Many governments place a high priority on developing their indigenous private sector to participate in and lead future growth. A related and equally pressing issue is raising the ability of the self-employed and rural poor to sustain the economic activities essential to their survival. A diversified financial sector capable of meeting the full range of demand for financial services of low income households, including informal and small businesses, is needed to facilitate these objectives.

In the absence of savings accounts and good possibilities for buying and selling assets, rotating savings and credit associations can play a key role in saving. These associations are seen worldwide under many different names and generally they tend to function in the same basic way. First, they have a fixed life span. Within that span, members contribute funs weekly or t other regular intervals. with each round of contributions to the common pot, one member of the group is given the whole amount. The pot is typically used to buy goods that are too costly (and not divisible) to purchase with the typical weekly cash flow of households.

Micro finance is being extended tot he poor by both micro finance providers and micro finance institutions. Both provide loans under micro finance either directly to individuals or through groups and co-operatives. Many NGOs receive financial assistance in the form of grants and loans for implementing various welfare and livelihood programmes of the government and donor agencies. On their part, certain financial institutions also provide assistance to the NGOs and other micro finance institution for implementing various programmes including credit programmes. There is, however, no regular institutional mechanism for providing assistance to the micro finance institutions for implementing such socially relevant empowerment and micro-finance programmes. For banks and development financial institutions (DFIS) on the other hand, a support mechanism for their credit operations, including micro fiance, exists which comprises an institutionalized system for capital infusion, refinance, training and other capacity building assistance from GOI, RBI, state government and other national and international agencies.

The components of support mechanism for the micro finance providers and micro finance institutions would vary depending upon the mode of micro finance. As regards support mechanism for banks' conventional lending to individuals under weaker section credit through cooperatives, there are comprehensive instructions and clear guidelines on lending norms, refinance, training, guarantee cover, etc.

Regarding various micro-credit delivery mechanisms implemented by micro finance institutions, the present support system seems to be grossly inadequate and cells for massive financial assistance to the micro finance institutions and a favourable policy framework on their role in banking with poor.

In making the execution of Micro Finance a success, inter linkages of SHGs and Financial Institute is critical and faces related to policy, operational, attitudinal, political, social and so forth.

The picture is changing very rapidly due to Self Help Groups, Cooperatives, and linkages amongst them, NGOs, Government intervention and credit nodal agencies like NABARD, Life Insurance Corporation and other Government owned Insurance Companies also couples saving with insurance cover scheme for poor people.

The Self Help Group is one way to fight against poverty in long run. NABARD is working in this direction through the innovations in micro finance. It provides the financial system in India with valuable insights for addressing the massive task of mainstreaming the very poor and the underprivileged with the formal banking system. SHG is composed of people of similar wavelength in terms of goal, economical and social conditions. The group of such small persons informally works together for some common cause on combining their own strengths and weaknesses.

4. SELF HELP GROUPS AND SOCIO-ECONOMIC DEVELOPMENT:

Self Help Group (SHG) is a voluntary group of rural and urban poor who face similar situations and problems. It is simple but efficient and effective method for the poor to help each other. It encourages small savings (thrift) among members and provides a forum for the members to solve their problems collectively. Optimum number of people in a SHG range from 15 to 20. After sufficient period of internal lending of savings, members develop confidence to access bank credit for larger needs. It helps in maturing credit habits and peer pressure of members ensures proper use of funds and excellent repayment rates. The regular discussions and interaction of the group facilitate social economic empowerment of members.

The banks would be largely benefited from the reduced transaction cost through economics of scale due to SHGs. It provides externalizing credit supervision and servicing to the NGOs or to the SHGs themselves. Bank would also be benefited from mobilization of small savings through groups, going access to low cost funds. Also, peer pressure within SHGs to perform well acts as an excellent substitute for collaterals, lending to more than 95% repayment thereby reducing the default risk. This also helps in getting timely repayment lending to faster recycling of funds. Banks and the Governments need to recognize SHGs as the appropriate medium for expansion of business of rural branches for wider coverage of clientele. Through such groups banks are also benefited from refinance from NABARD, lending to overall reduction in the cost of funds.

SHGs also help the members of the group as discussion among SHG members helps each other solve common problems. They collect and use own savings to make interest bearing small loans to themselves. They learn to set terms and conditions and keep accounts for money and gradually internalize financial discipline. Slowly and steadily these groups start handling resources of a size much beyond their individual capacity. These groups also win the confidence of the normal banking system through mature financial behaviour, lending to further access to funds. They learn to interact with external environment in a meaningful way, leading to increased self esteem and social environment.

5. SOLUTIONS VISIBLE IN LIGHT OF THE ABOVE CHALLENGES :

The solutions seems visible in framing strategy to increase access to financial services and low-income households by addressing few areas:

a) there is a need for banks to focus efforts at fostering strategic partnerships with local Micro Finance Institutions (MFIs) and Non-Governmental Organizations (NGOs), which over the last decade have been instrumental in providing basic financial services outside the formal banking system, in order to ramp up its outreach at a rapid pace. While few of these organizations have achieved a sizeable scale of operation, most, despite some very good track record of performance, have not been able to scale up their operations.

b) Formulations of policy, creation of suitable legal structure and regulatory frameworks will allow

innovative financial institutions to develop and operate effectively.
c) Stress is also required to be given on the importance of leveraging technology to avoid revenue and knowledge leaks. With MFIs rising in efficiencies, they become ideal channels for several schemes that the Government Currently drives.
d) Providing exposure to and training in the best practices that banks and micro-finance organizations need to expand their outreach and develop sustainable operations, along with performance-based support for capacity building;
e) Leasing, lending and providing other products of financial credit facilities tailored to meet local needs that increase access to financial services.
f) Creating awareness among poor. The most vulnerable community members are not aware what they themselves can do to come out from the situation. They need motivation and guidance.
g) By training poor people after tracing them from mass to make them enable to develop on their own.
h) Mitigation of various risk factors such as credit risk, repayment risk, Creation of appropriate rights on the underlying cash flow receivables and servicing risk etc through the help of SHGs.
i) Stressing on leadership development in rural areas, professionalizing external linkages and sustainability will also pay role in success of Micro Finance industry.
j) Government also need to play a very important role in facilitating all the above. Ministry of state for Rural Development has already initiated the process of transforming its current wage-based program to facilitate self-employment among the rural population. There is also need for providing market access to the rural population and to a large extent requires private sector to take lead in it.

The livelihood of millions of poor households depend upon the agriculture, allied and non-farm sectors which requires extending micro-credit to them. With a market share of 150 million farmers, the Indian Microfinance sector is considerably more developed compared with other emerging countries. India's Microfinance institutions reached 76.6 million against last year's 59 million, according to the "state of the Sector Report". The pace with which microfinance has grown during the past years is also commendable.

6. CONCLUSION:

Indian rural finance sector is at crossroads today. After the financial sector debacle in the US and the recessionary fears looming largely over most economies, banks are increasingly shying away from rural lending as well as rationalizing their branch network in rural areas. Some of the studies point out that while between 1977 and 1990 (pre reform period) more bank branches were opened in financially less developed areas, the pattern was reversed in post reform period. State Bank of India is taking strides in the direction of providing fillip to this gap. It has recently in February 2010 opened 1,00,000th branch in financially less developed area. Also while, access of credit to the rural poor has reduced in post reform period, this gap is being largely filled in through micro credit. The SHG-Bank linkage programme has witnessed phenomenal growth. It is expected that these SHG-Bank linkage programmes would largely contribute to poverty reduction in rural India. The significance of brining the focus back to 'people' from 'institutions' and adoption of localized people centric approach hardly needs any overemphasis. In line with the views of commercial microfinance, it is pertinent to use the scare public resources judiciously and with the better targeting. In this backdrop, the impressive gains made by SHG-Bank linkage programme in coverage of rural population with financial services offers a ray of hope.

The Indian economy at a crucial juncture, on one hand, the optimist are talking of India being among the top 5 economies of the world by 2050 and on the other hand India is home over 260 million poor forming almost 26% of the total population. The enormity of the task can be gauged from the above members and if India is to stand among the league of developed nations, there is no denying the fact That poverty alleviation & reduction of income inequalities has to be the top most priority. India's achieving a broad based economic growth hinges completely on a successful poverty alleviation strategy and the role played largely by micro-finance in the socio economic development of the poor in India.

A support mechanism, motivation and training also become relevant in making micro finance a movement. Unless Micro Finance becomes peoples' movement, success to join the league of developed economies is out of sight.

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