

# An Analysis upon the Recent Development of Microfinance: A Tool of Poverty Alleviation

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**Abstract – Microfinance programme has been generally regarded as a development strategy that can enhance the economic performance of the poor. The government of India has made concerted efforts to alleviate poverty in the country. One of such efforts is Poverty alleviation through Microfinance loan but poverty still remains pervasive and widespread in the country especially in the rural communities. Microfinance Institutions are implored to create more awareness on their operations and make less stringent conditions for the loan accessibility. To know how microfinance does increased the income level and standard of the poor from low income level to high income. Microfinance was proved to be a great tool to fight against poverty and to empower the low income households and groups in the study area. Microfinance proved to be a great tool for economic development and for alleviating poverty from the society. It also helped in pushing up low income groups of society, community and merge as unique blend for financial and social intermediation. Microfinance was the key strategy that leads to immediate revitalization of economy; enhance their living standards, women empowerment and employment generation.**

**Many developing countries like India, Bangladesh and Pakistan are using microfinance to increase the living standard of their people. But in India main focus of Microfinance Institutes (MFIs) was only to give credit. There is a strong relationship between microfinance and poverty alleviation. The results also showed that Microfinance Scheme help people to improve their living standard and provide them financial opportunity to expand their business. Microfinance is the key strategy that leads to quick recovery of economy, increase in living standard Microfinance playing a vital role improving standard life of rural people, people facing many problems sanctioning loan from formal financial Institution. In the event that one can help, a needy individual to remain all alone that can't just realize a transformation in their lives additionally in the general public. The fantasy of a sound and taught society with no separation and one-sided can be accomplished through this basic thought, the fantasy which is by all accounts working out as expected and getting to be reasonable.**

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## INTRODUCTION

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 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. Microfinance has been a panacea for poverty reduction in India and thus it is profoundly promoted by our financial system throughout the economy. Moreover the phenomenon, as an important part of our innovative financial tool, must be sharing certain relationship with various economic indicators. Such a financing tool helps in increasing the economic activities in a country and thus adds value to the economic growth as a whole. And if economy grows it improves the financial system and

thus such financial tools. Micro finance: Micro finance includes wide range of facilities of services to poor such as savings microcredit and the insurance. Microfinance institution provides the small loan to poor people who are disqualified for the formal loan. According to Conroy (2002), Micro finance is the wide range of provision of financial services included services of payment, accepting deposits, lending loans transfer of money and insurance to low income and poor people.

Whereas the two terms such as micro enterprises and micro credit financing include the value of borrowing as well as savings. Microfinance is the whole field whereas the other two terms are specifically related to provision of credit. Micro credit: Micro credit can also be called micro lending it can be defined as “A very small loan given to poor people for helping them to be selfemployed”. It is given to poor ones for increasing the living standard of loan taker by investing it in income giving

activities. Microcredits are: These loans are too small, no collateral Required, mostly have weekly payments, short term such that less than one year loan, it is mostly for the women and poor people who are not eligible for borrowing the formal loan. In micro credit, the interest rates are high due to high micro credit program running cost. This rate can be reduced by reducing its high-cost operation by innovation, efficiency and by enhancing market competition. Microfinance is the act of providing whole range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their microenterprises. It is also worth mentioning here to make an important clarification that most people think that microfinance is charity from government or donor agencies provided to poor section of community. The dynamic growth of the microfinance industry has been promoted not only by market forces but also by conscious actions of national governments, Non-Governmental Organizations (NGOs), and the donors who view microfinance as an effective tool for eradicating poverty. Microfinance is emerging as a powerful instrument for poverty alleviation in the new economy In India.

Microfinance is the term that has been used interchangeably with micro-credit. Microfinance refers to loans, savings, insurance, transfer services, micro-credit loans and other financial products targeted at low-income clients. Microfinance is not simply banking for the poor; it is a development approach with a social mission and a private sector-based financial bottom line that uses tested and continually adjusted sets of principles, practices and technologies. The key to successful microfinance lies in the ability of the provider to cost-effectively reach a critical mass of clients with systems of delivery, market responsiveness, risk management and control that can generate a profit to the institution. e to improve micro-finance services for substantial contribution on poverty reduction and sustainability of the MFIs. Microfinance programs have the potential to transform power relations and empower the poor—both men and women. Microfinance aims at assisting communities of the economically excluded to achieve greater degree of asset creation and income security at the household and community level, by promoting self-employment, income opportunities through the creation and expansion of micro-enterprises and increased productivity. They found that micro finance was one of the essential elements to remove the poverty and the improvement of rural women capacity. In modern period, small loan, in its spread scope known as microfinance or micro credit, has become a much favored element for poverty reduction in the developing countries and least development countries. The 1997 Microcredit Summit held in Washington D.C., launched a global movement to reach 100 million of the world's poorest families with credit for self-service and other financial and business services by the year 2005. According to the

Microcredit Summit Campaign Report, 67.6 million families have been reached by microcredit in 2002 around the world. The microcredit participants are more capable of taking their economic and household decision making. MFI is positively related to economic decision making empowerment, household decision making empowerment, freedom of movement empowerment, ownership of property empowerment, political and social awareness and overall empowerment. Microfinance institutions are providing the services of microcredit, savings and insurance. According to Menon (2005), microfinance or microcredit is the extension of small loans to individuals who are too poor to qualify for traditional bank loans, as they have no assets to be offered as guarantee. Microfinance is the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services. Micro-credit is something which is not going to disappear... because this is a need of the people, whatever name you give it, you have to have those financial facilities coming to them because it is totally unfair... to deny half the population of the world financial services. Dr. Muhammad Yunus, Founder Bangladesh Grameen Bank, in March 2002. Micro finance has tremendous potential as an Instrument for poverty reduction in Shahid Khandker, Senior Economist, World Bank, in 1999 ([www.reliefweb.int](http://www.reliefweb.int)). Microfinance has been an important component in poverty reduction scheme of the Government and development agencies in India. Microfinance has taken on a transnational trajectory, and millions of people worldwide designated as the "poorest of the poor" have benefitted from microfinance products provided by MFIs locally and internationally. Nobel Peace Prize winner, Mohammad Yunus, is credited for the microfinance movement, which began in the villages of Bangladesh in the 1970s through the Grameen Bank. Microfinance role goes beyond business investment, to include the improvements in the economic wellbeing of households such as, clients' health, nutrition, children education and standard of their life.

India has a Savings to GDP ratio of 33% which is the highest in the world. Indian is the nation of savers and investors and above that more than 52% of the population is below 25 years of age, this creates a need for developing a population which is financially literate. Moreover 85% of the household savings is parked in fixed deposits. In India, household savings in shares, including mutual funds is around 7%. In the US, 50% of household savings are in mutual funds and shares. This is one of the factors for low household net worth in India.

Microfinance is the fastest growing sectors of India; microfinance is spearheading intense competition among the largest players. By the end of March 2009, microfinance institutions expanded their outreach to 50 million households and about 38 million borrowers. These institutions are organized under three models: SHG, Grameen model/Joint

liability groups and Individual banking groups as in cooperatives. As of March 2009, both SHG bank linkage and MFIs have collectively disbursed US\$3.9 billion to the poor. Most poor people cannot get good financial services that meet their needs because there are not enough strong institutions that provide such services. Strong institutions need to charge enough to cover their costs. Cost recovery is not an end in itself. Rather, it is the only way to reach scale and impact beyond the limited levels that donors can fund. Especially in developing countries, where microfinance has its origin, is playing an important role in poverty reduction. Its target is the poor who have been neglected by formal financial sectors. It provides job opportunities and increases the life quality of them, raises the household revenues and in consequence provides more access to education, nutrition and health services. Main reasons that the poor cannot develop economically is the lack of access to loans and formal banking systems because his access to acceptable collateral, assets and legal documents is deficient. On the other side, since the cost of control and monitoring of these loans is high for the commercial banks, they see it less profitable and so are less tended to make lending to these groups. . Microfinance institution provides the small loan to poor people who are disqualified for the formal loan. The basic purpose of micro credit is to provide the money to low income people and the poor to use it in activities of businesses and also for improving their life standards. Interest rate, economic condition credit worthiness; non availability of information, gender difference and govt. policies etc affects the demand of microfinance in India.

In the past two decades, microfinance programmes have been considered by the development economists as one of the foremost strategies for poverty reduction. Although some researchers argue that Microfinance has not really succeeded in its role as grassroots economic developer in the sense that it has not been effective in reaching the poorest. But others opine that the programme is capable of bringing the poor into the lime light if properly implemented. This debate creates the gap for independent researchers to further examine the impact of Microfinance on poverty alleviation as donors and practitioners may be biased in their assessment. It is therefore believed that this study will contribute to literature and further make clarification on this debate by examining the impact of microcredit on poverty alleviation using Nigeria, the most populous black nation in the world as a case study.

Poverty contributes to underdevelopment and its reduction leads to economic development. To be poor connotes deprivation from the basic necessities of life. In fact, poverty engenders inability to afford the minimum basic essentials like food, children education, good housing, healthcare and good

clothing to mention few. Suffice to say that the poor are being denied their share of the nation's resources and other necessities that are generally available in the society for their comfort.

Poverty is a worldwide socio-economic problem. Hence, its awareness is much more favored at the international level of finance and governance. For example, the World Bank, United Nations (UN) and International Monetary Fund (IMF) have developed various programmes and projects that would improve the life of the poor, ensure health improvement and sustainable growth and development.

## **MICROFINANCE IN INDIA**

Microfinance sector has grown rapidly over the past few decades. Nobel laureate Muhammad Yunus is credited with laying the foundation of the modern MFIs with establishment of Grameen Bank, Bangladesh in 1976. Today it has evolved into a vibrant industry exhibiting a variety of business models.

Microfinance banking financial companies (NBFCs), commercial banks, regional rural banks (RRBs), cooperative societies and other large lenders has played an important role in providing refinance facility to MFIs. Banks have also leveraged the self-help group (SHGs) channel to provide direct credit to group borrowers.

With financial inclusion emerging as a major policy objective in the country, microfinance has occupied centre stage as promising conduit for extending financial services to unbanked sections of population. At the same time, practice followed by certain lenders have subjected the sector to greater scrutiny and need for stricter regulation.

According to Kofi Annan (former Secretary General of the UNO) states that "Microcredit is a critical anti-poverty tool a wise investment in human capital. When the poorest, especially women, receive credit, they become economic actors with power. Power to improve not only their own lives but, in a widening circle of impact, the lives of their families, their communities, and their nations." Micro finance is a novel approach to 'banking with the poor' and this system attempts to combine lower transaction costs and high degree of repayments. According to recent survey More than One billion poor people have no access to basic financial facilities, which are essential for them to manage their precarious lives.

The Indian government and state authorities should realize the consequences of devoting awareness to the economic betterment of women in India. More awareness programmes, more training for supporting themselves and schemes should be provided to the rural women. SHG being one of the means to improve rural development should be

emphasized more on the rural women (women not only gain financially but gain self-esteem in the society) Government should put more effort in encouraging these groups by providing more schemes and making sure that these schemes are utilized and received by the proper groups because these schemes that are given for the upliftment of SHGs not only help the SHG members in making their standard of living better but helps in making the society better as a whole.

The Grameen Bank provides loan landless poor, particularly women, to promote self-employment. This very project became successful and India adopted this Bangladesh model in modified form. 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 capita income is only \$ 3262. This is not enough to provide food to more than one individual.

## MICROFINANCE AND POVERTY

During recent years microfinance is the most researched area. Still there is no universally accepted definition of microfinance. Various authors and agencies have defined microfinance in different ways. Some of these are given below: A definition of microfinance provided by Robinson (1998) "Microfinance refers to small-scale financial services for both credits and deposits — that are provided to people who farm or fish or herd; operate small or microenterprises where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries, in both rural and urban areas".

According to ADB (2000), Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their microenterprises. Microfinance services are provided by three types of sources:

- Formal institutions, such as rural banks and cooperatives;
- Semiformal institutions, such as nongovernment organizations
- Informal sources such as money lenders and shopkeepers.

Institutional microfinance is defined to include microfinance services provided by both formal and semiformal institutions.

Task Force on Supportive Policy and Regulatory Framework<sup>6</sup> for microfinance setup by NABARD defines microfinance as:

"Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi urban or urban areas for enabling them to raise their income levels and improve living standards."

The Task Force emphasizes that microfinance will cover not only consumption and production loans, but also include other credit needs such as housing and shelter improvement, while other financial services like savings and insurance are also included under it. Microfinance is very often accompanied by non-financial! and other business services like capacity building, forward and backward linkages, etc., provided either by the same or by some other institutions, mainly for enhancing the productivity of credit.

## Linkage between Microfinance and Poverty-

Theories of development advocate that financial development creates enabling conditions for growth through either a 'supply-leading' (financial development spurs growth) or a 'demand-following' (growth generates demand for financial products) channel. The early literature on the subject focused on the need to develop an extensive financial system that could tap savings and then channel the funds so generated to a wide spectrum of activities. The modern development theory perceives the lack of access to finance as a critical factor responsible for persistent income inequality as well as slower growth (Greenwood & Jovanovic, 1990). A large body of empirical literature suggests that developing the financial sector and improving access to finance may accelerate economic growth along with a reduction in income inequality and poverty (Karian & Morduch, 2009). Without an inclusive financial system, poor individuals and small enterprises have to rely on their own limited savings and earnings to invest in their education and entrepreneurship to take advantage of growth opportunities (World Bank, 2007). Operational holdings in India are small and marginal and are not economically viable. The condition of poor in nonfarm activities is also precarious. Lack of adequate credit has remained the major constraint in the upliftment of poor.

## MICROFINANCE MODELS IN INDIA

There are two broad approaches for delivering microfinance to the poor clients in India

1. SHG-Bank Linkage programme
2. Microfinance Institutions (MFIs)

### **SHG-Bank Linkage Programme-**

Due to the inadequacies of the formal financial system to cater the financial needs of the rural poor, NABARD launched an action research project in 1987 through an NGO called MYRADA. NABARD provided a grant of Rs. 1 million (\$22,222) to MYRADA for an R&D programme related to credit groups. Encouraged by the results of field level experiments in group based approach for lending to the poor, NABARD launched a Pilot Project in 1991-92 in partnership with Non-governmental Organisations (NGOs) for promoting and grooming self- help groups (SIIGs) of homogeneous members and making savings from existing banks and within the existing legal framework. Steady progress of the pilot project led to the mainstreaming of the SHG-Bank Linkage Programme in 1996 as a normal banking activity of the banks with widespread acceptance. A microfinance scenario in India is dominated by SHG-Bank linkage programme due to its adoption by state owned financial institutions like Commercial Banks, Regional Rural Banks and Cooperative Banks (Singh, 2008). SHG-BLP is the largest microfinance service programme, involving around 5,000 NGOs, and covering about 50 million families through 3.4 million SHGs (EDA Rural, 2009). According to RBI "A Self-Help Group (SHG) is a registered or unregistered group of micro entrepreneurs having homogenous social and economic background voluntarily, coming together to save small amounts regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis. The group members use collective wisdom and peer pressure to ensure proper end-use of credit and timely repayment thereof. In fact, peer pressure has been recognized as an effective substitute for collaterals".

### **Microfinance Institutions-**

This second model of microfinance in India is mainly a private sector initiative. Semi-formal institutions that undertake microfinance services as their main activity are referred as microfinance institutions (MFIs). MFIs are an extremely heterogeneous group comprising Non-Banking Finance Companies (NBFC), Societies, Trusts and Cooperatives. They are provided financial support from external donors and apex institutions including the Rashtriya Mahila Kosh (RiMK), SIDBI Foundation for Micro Credit and NABARD and employ a variety of ways for credit delivery (Batra, & Sumanjeet 2011). Task Force on Supportive Policy and Regulatory Framework for microfinance (1998) setup by NABARD define MFIs as:

"Microfinance institutions (MFIs) are those which provide thrift, credit and other financial services and products of very small amounts mainly to the poor in rural, semi-urban or urban areas for enabling them to

raise their income levels and improve living standards".

### **CONCLUSION**

Micro finance has been found as the approach and tool for poverty alleviation and empowerment of rural women. The SHGs have made a revolution in the Poor folk by enabling them to become self-dependent, self-reliant and self-employed. The core theory that logically validates the application of microfinance scheme to raise the income and other assets of the rural poor advanced that as long as the returns of the microfinance projects are more than the costs of loans and the value of marginal propensity to consume is less than one, growth rate of capital accumulation is positive. Microfinance is considered an important tool .microfinance program has not only helps in financial inclusion. But it also promotes banking habits, saving behavior and better financial utilization among the poor. Poor is provided as possible as microcredit to meet their needs of education, marriages etc. The microfinance sector in India is on a growth. It cannot be denied that it shares a causal relationship with other economic indicators.

The potential for growing micro finance institutions in India is very high. Major cross-section can have benefit if this sector will grow in its fastest pace. As Micro finance becomes more widely accepted and moves into main stream, the supply of services to poor may also increase, improving the efficiency and outreach while lowering the costs. Microfinance services are going for the training their business with growth prospectus .providers of microfinance services need to realize Micro credit programs have a strongly positive relationship with poverty alleviation; this is the proven fact. But, the only requirement is that the loan giving authorities really mean it. It is not a simple task to help the poor, as they are poor in every respect. The geographical location of the poorest and the broader environment in which they operate also make it more difficult to serve them.

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