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MICRO FINANCE: A CONCEPTUAL ANALYSIS

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ABSTRACT

Microfinance is a movement whose object is "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."More than 150 million poor people have access to collateral-free loans .However; there are still large sections of the world population that are excluded from the financial services market. In India half of the poor are financially excluded from the country's main stream of the banking sector. Still in India 22 percent of the people are living below the poverty line. Their monthly income is less than $1 per day and they are living in most un-liveable conditions. In India, growth with equity has been the central objective right from the inception of the planning process. The eleventh Five year plan (2007-12) re-emphasized the need for a more inclusive growth in order to ensure that the per capita income growth is broad-based. More and more Indian companies are trying to enter in the list of fortune 500 and one of our Indian entrepreneurs appears in the list of the top five richest persons of the world. The paper discuss about tackling this disparity between people by ways of financial inclusion through micro finance models and it also analyses how that leads to the economic development of a country.

KEYWORDS: *Economic Development, Financial Inclusion, Micro finance, MFOs, Poverty Alleviation, SHGs.*

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1. INTRODUCTION

Microfinance is usually understood to entail the provision of financial services to micro-entrepreneurs and small businesses, which lack access to banking and related services due to the high transaction costs associated with serving these client categories. The two main mechanisms for the delivery of financial services to such clients are (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group.

In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which however is closer to the retail finance model prevalent in mainstream banking. For some, microfinance is a movement whose object is "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." Many of those who promote microfinance generally believe that such access will help poor people out of poverty. For others, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Although microcredit is one of the aspects of microfinance, conflation of the two terms is endemic in public discourse. Critics often attack microcredit while referring to it indiscriminately as either 'microcredit' or 'microfinance'. Due to the broad range of microfinance services, it is difficult to assess impact, and very few studies have tried to assess its full impact.

Micro-finance economically disadvantaged segments of society, for enabling them to raise their income levels largest in term of population after China. India's GDP ranks among the top 15 economies of the world. However, around 300 million people or about 80 million households are living below the poverty line, i.e. less than $2 per day according to the World Bank and the poorest are which earns $1 per day. It is further estimated that of these households, only about 20% have access to credit from the formal sector. Out of these 80 million house hold, 80% takes credit from the informal sources i.e. local Zamidars, Chit Funds etc. With about 80 million households below MFIs include non- governmental organizations (NGOs), credit unions, non-bank financial intermediaries, and even a few commercial banks.

1.1 NEED OF THE STUDY

• The need of microfinance arises because the rural India requires sources of finance for poverty alleviation, procurement of agricultural and farms input.

• Micro finance is a programme to support the poor rural people to pay its debt and maintain social and economic status in the villages.

• As we know that India is agriculture based economy so microfinance may be a tools to empower the farmers and rural peoples to make agriculture profitable.

• So the researchers are interested to find out the scopes of microfinance in rural India. This research paper is highlighting a picture rural India as a profitable segment for microfinance institutions.

1.2 FINANCIAL NEEDS OF POOR PEOPLE

FINANCIAL NEEDS AND FINANCIAL SERVICES

In developing economies and particularly in the rural areas, many activities that would be classified in the developed world as financial are not monetized: that is, money is not used to carry them out. Almost by definition, poor people have very little money. But circumstances often arise in their lives in which they need money or the things money can buy.

In Stuart Rutherford's recent book The Poor and Their Money, he cites several types of needs:

- Lifecycle Needs: such as weddings, funerals, childbirth, education, homebuilding, widowhood, old age.
- Personal Emergencies: such as sickness, injury, unemployment, theft, harassment or death.
- Disasters: such as fires, floods, cyclones and man-made events like war or bulldozing of dwellings.
- Investment Opportunities: expanding a business, buying land or equipment, improving housing, securing a job (which often requires paying a large bribe), etc.

Poor people find creative and often collaborative ways to meet these needs, primarily through creating and exchanging different forms of non-cash value. Common substitutes for cash vary from country to country but typically include livestock, grains, jewelry, and precious metals.

As Marguerite Robinson describes in The Microfinance Revolution, the 1980s demonstrated that "microfinance could provide large-scale outreach profitably," and in the 1990s, "microfinance began to develop as an industry" (2001, p. 54). In the 2000s, the microfinance industry's objective is to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty. While much progress has been made in developing a viable, commercial microfinance sector in the last few decades, several issues remain that need to be addressed before the industry will be able to satisfy massive worldwide demand.

2. LITERATURE REVIEW

Over the past centuries practical visionaries, from the Franciscan monks who founded the community-oriented pawnshops of the 15th century, to the founders of the European credit union movement in the 19th century (such as Friedrich Wilhelm Raiffeisen) and the founders of the

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microcredit movement in the 1970s (such as Muhammad Yunus) have tested practices and built institutions designed to bring the kinds of opportunities and risk-management tools that financial services can provide to the doorsteps of poor people. While the success of the Grameen Bank (which now serves over 7 million poor Bangladeshi women) has inspired the world, it has proved difficult to replicate this success. In nations with lower population densities, meeting the operating costs of a retail branch by serving nearby customers has proven considerably more challenging. Hans Dieter Seibel, board member of the European Microfinance Platform, is in favor of the group model. This particular model (used by many Microfinance institutions) makes financial sense, he says, because it reduces transaction costs. Microfinance programmes also need to be based on local funds. The history of micro financing can be traced back as long to the middle of the 1800s when the theorist Lysander Spooner was writing over the benefits from small credits to entrepreneurs and farmers as a way getting the people out of poverty. Independently to Spooner, Friedrich Wilhelm Raiffeisen founded the first cooperative lending banks to support farmers in rural Germany.

The modern use of the expression "micro financing" has roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Muhammad Yunus, were starting and shaping the modern industry of micro financing. Another pioneer in this sector is Akhtar Hameed Khan.

3. PRINCIPLES OF MICRO FINANCE

Some principles that summarize a century and a half of development practice were encapsulated in 2004 by Consultative Group to Assist the Poor (CGAP) and endorsed by the Group of Eight leaders at the G8 Summit on June 10, 2004:

1. Poor people need not just loans but also savings, insurance and money transfer services.
2. Microfinance must be useful to poor households: helping them raise income, build up assets and/or cushion themselves against external shocks.
3. "Microfinance can pay for itself." Subsidies from donors and government are scarce and uncertain, and so to reach large numbers of poor people, microfinance must pay for itself.
4. Microfinance means building permanent local institutions.
5. Microfinance also means integrating the financial needs of poor people into a country's mainstream financial system.
6. "The job of government is to enable financial services, not to provide them."
7. "Donor funds should complement private capital, not compete with it."
8. "The key bottleneck is the shortage of strong institutions and managers." Donors should focus on capacity building.

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9. Interest rate ceilings hurt poor people by preventing microfinance institutions from covering their costs, which chokes off the supply of credit.

10. Microfinance institutions should measure and disclose their performance – both financially and socially.

4. OBJECTIVES OF THE STUDY

- To review the present status of the micro finance in India in particular and the world general.
- To highlight the measures taken by the Government of India and RBI for promoting micro finance
- To highlight how the micro finance models are useful to increase Financial Inclusion.
- To understands the marketing of microfinance products in rural market.
- Finding out the role of Self Help Groups (SHGs) in micro finance.
- To study the importance and role of microfinance in poverty alleviation and

Profitable agriculture activities

5. RESEARCH METHODOLOGY

This is a descriptive research paper based on secondary data. Secondary research was conducted to review the present status of Micro Finance in India. Data has been collected from the websites of the Reserve Bank of India, NABARD, MFIs, various publication of Economic survey and also taken from various committee reports submitted to Government of India on micro finance, research paper, journals, books and magazines

6. LIMITATIONS OF MICRO FINANCE

The obstacles or challenges to building a sound commercial microfinance industry include:

- Inappropriate donor subsidies
- Poor regulation and supervision of deposit-taking MFIs
- Few MFIs that meet the needs for savings, remittances or insurance
- Limited management capacity in MFIs
- Institutional inefficiencies
- Need for more dissemination and adoption of rural, agricultural microfinance methodologies

7. FACTORS AFFECTING ACCESS TO FINANCIAL SERVICES

- **GENDER ISSUES**

Access to credit is often limited for women who do not have, or cannot hold title to assets such as land and property or must seek male guarantees to borrow.

- **AGE FACTOR**

Financial service providers usually target the middle of the economically active population, often overlooking the design of appropriate products for older or younger potential customers.

- **LEGAL IDENTITY**

Lack of legal identities like identity cards, birth certificates or written records often exclude women, ethnic minorities, economic and political refugees and migrant workers from accessing financial services

- **LIMITED LITERACY**

Limited literacy, particularly financial literacy, i.e., basic mathematics, business finance skills as well as lack of understanding often constraints demand for financial services.

- **PLACE OF LIVING**

Although effective distance is as much about transportation infrastructure as physical distance, factors like density of population, rural and remote areas, mobility of the population (i.e., highly mobile people with no fixed or formal address), insurgency in a location, etc., also affect access to financial services.

- **PSYCHOLOGICAL AND CULTURAL BARRIERS**

The feeling that banks are not interested to look into their cause has led to self-exclusion for many of the low income groups .However, cultural and religious barriers to banking have also been observed in some of the countries Social security payments

- **BANK CHARGES**

In most of the countries, transaction is free as long as the account has sufficient funds to cover the cost of transactions made. However, there are a range of other charges that have a disproportionate effect on people with low income.

- **TERMS AND CONDITIONS**

Terms and conditions attached to products such as minimum balance requirements and conditions relating to the use of accounts often dissuade people from using such products/services.

- **LEVEL OF INCOME**

Financial status of people is always important in gaining access to financial services. Extremely poor people find it difficult to access financial services even when the services are tailored for them. Perception barriers and income discrimination among potential members in group-lending programmes may exclude the poorer members of the community.

- **TYPE OF OCCUPATION**

Many banks have not developed the capacity to evaluate loan applications of small borrowers and unorganized enterprises and hence tend to deny such loan requests.

- **ATTRACTIVENESS OF THE PRODUCT**.

Both the financial services/products (savings accounts, credit products, payment services and insurance) and how their availability is marketed are crucial in financial inclusion.

According to Report on Currency and Finance 2006-08 the critical dimensions of Financial exclusion include access exclusion, condition exclusion (conditions attached to financial products), price exclusion and self exclusion because of the fear of refusal to access by the service providers. The financial exclusion process becomes self-reinforcing and can often be an important factor in social exclusion, especially for communities with limited access to financial products, particularly in rural areas.

One of the successes in the last few years is supposed to have been the Mahatma Gandhi National Rural employment Guarantee Scheme. It has increased financial inclusion because it is mandated into the scheme that payments are made through the job cards, through bank accounts. Prior to this scheme of ‘No frills accounts’, as directed by the RBI, paved the way for Financial Inclusion. It is mandatory for state agencies to make the payments under various social security schemes through bank account

8. FINANCIAL INCLUSION: AN OVERVIEW

More recently, the term financial inclusion has gained argument among professionals. “Financial Inclusion” focuses attention on the need to bring previously excluded people under the umbrella of financial institutions. There is no universally accepted definition of financial inclusion. Financial Inclusion is generally defined in terms of exclusion from the financial system. The working or operational definitions of financial exclusion generally focus on ownership or access to particular financial products and services .Furthermore, the definitions have witnessed as shift in emphasis from the earlier ones, which defined financial inclusion and exclusion largely in terms of physical access, to a wider definition covering access to and use and understanding of products and services.

Rangarajan's committee on financial inclusion defines it as:

“Financial inclusion may be defined as the process of access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.”

The financial services include the entire gamut - savings, loans, insurance, credit, payments etc. The financial system has to provide its function of transferring resources from surplus to deficit units but both deficit and surplus units are those with low incomes, poor background etc. By providing these services, the aim is to help them come out of poverty. So far, the focus has only been on delivering credit (it is called as microfinance but is microcredit) and has been quite successful.

The access to finance could be divided into four segments:

1. The proportion of the population that uses a bank or bank like institution
2. Population which uses services from non-bank “other formal” financial institutions, but does not use bank services
3. The population which only uses services from information financial service providers
4. Percentage of population transacting regularly through formal financial instruments and,
5. The population which uses no financial services.

Since measuring inclusion is perceived to be difficult, financial inclusion has generally been defined in terms of exclusion from the financial system. It focuses on ownership or access to particular financial products and services. Specific indicators such as number of bank accounts, number of bank branches that are generally used as measures of financial inclusion can provide only partial information on the level of financial inclusion in an economy.

In India, the financially excluded sections comprise largely marginal farmers, landless labourers, oral lessees, self employed and unorganized sectors enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women. Some of the important causes of relatively low extension of institutional credit in the rural areas are risk perception, cost of its assessment and management, lack of rural infrastructure, and vast geographical spread of the rural areas with more than half a million villages, some sparsely populated.

8.1. RATIONALE FOR FINANCIAL INCLUSION

Finance has come a long way since the time when it wasn't recognized as a factor for growth and development. It is now attributed as the brain of an economic system and most economies strive to make their financial systems more efficient. It also keeps policymakers on their toes as any problem in this sector could freeze the entire economy and even lead to a contagion.

The first question that comes to mind is why can't financial inclusion happen on its own? Why do we need to make a policy to increase the same? Like any other product or service, why can't it find a market of its own? The reasons are:

1. **FINANCIAL EXCLUSION:** It has been found that financial services are used only by a section of the population. There is demand for these services but it has not been provided. The excluded regions are rural, poor regions and also those living in harsh climatic conditions where it is difficult to provide these financial services. The excluded population then hasto relies on informal sector (moneylenders etc) for availing finance that is usually at exorbitant rates. These leads to a vicious cycle. First, high cost of finance implies that first poor person has to earn much more than someone who has access to lower cost finance. Second, the major portion of the earnings is paid to the moneylender and the person can never come out of the poverty.

2. **HIGH COST:** It has also been seen that poor living in urban areas don't utilize the financial services as they find financial services are costly and thus are unaffordable. Hence, even if financial services are available, the high costs deter the poor from accessing them. For example, to open a checking account in Cameroon, the minimum deposit requirement is over 700 dollars, an amount higher than the average GDP per capita of that country, while no minimum amounts are required in South Africa or Swaziland. Annual fees to maintain a checking account exceed 25 percent of GDP per capita in Sierra Leone, while there are no such fees in the Philippines. In Bangladesh, Pakistan, Philippines, to get a small business loan processed requires more than a month, while the wait is only a day in Denmark. The fees for transferring 250 dollars internationally are 50 dollars in the Dominican Republic, but only 30 cents in Belgium.

3. **NON-PRICE BARRIERS:** Access to formal financial services also requires documents of proof regarding a persons' identity, income etc. The poor people do not have these documents and thus are excluded from these services. They may also subscribe to the services initially but may not use them as actively as others because of high distance between the bank and residence, poor infrastructure etc.

4. **BEHAVIORAL ASPECTS:** Research in behavioral economics has shown that many people are not comfortable using formal financial services. The reasons are difficulty in understanding language, various documents and conditions that come with financial services etc.

There are a number of positive externalities of financial inclusion. One of the important effects is one is able to reap the advantages of network externality of financial inclusion as the value of the entire national financial system increases. Yet another reason why financial inclusion is a quasi public good is that the consequent fuller participation by all in the financial system makes monetary policy more effective and thus enhances the prospects of noninflationary growth.

8.2 WHO ARE THE EXCLUDED AND WHY?

Many people across the globe are excluded from mainstream banking. These range from people with low income to people with low information and accessibility to people with no social security or insurance cover. The main reasons behind exclusion are:

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1. **LACK OF INFORMATION:** Lack of information about the role and function of banks, banking services and products, interest rates, etc. stop people from including themselves in mainstream banking.

2. **INSUFFICIENT DOCUMENTATION:** Many people (even in metropolis and urban areas) are unable to show their self identification documents during the opening of a bank account or during taking a loan.

3. **LACK OF AWARENESS:** Many people are unaware of the banking terms and conditions laid down from time to time.

4. **HIGH TRANSACTION CHARGES:** Various commercial banks across the globe levy transaction charges on credit or debit transactions, on over usage of banking services, on cheque book issuance etc

5. **LACK OF ACCESS:** Accessibility is a problem from all those people who live in geopolitically isolated regions. Moreover, as most of the commercial banks are located in the vicinity of cities, people in rural areas (mainly in developing countries) have a geographical barrier in accessing banks.

6. **ILLITERACY:** Because of illiteracy, a substantial number of people are unable to take recourse to banking services.

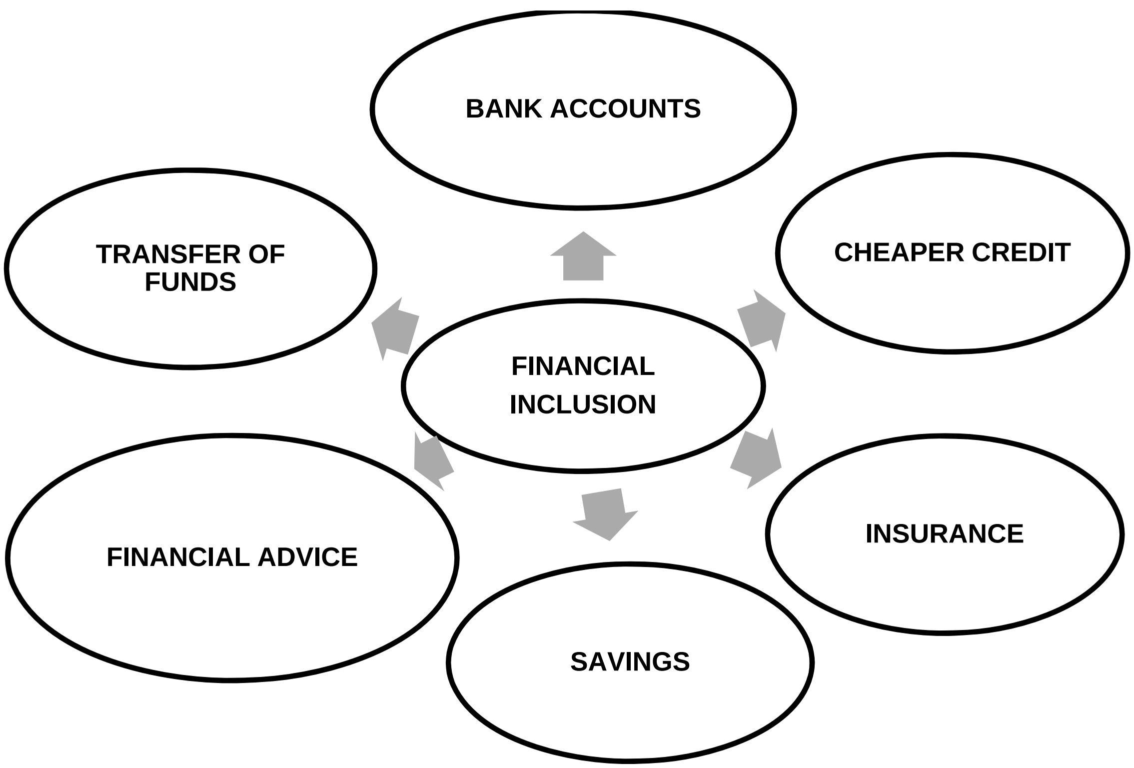

FIGURE 1 : AN OVERVIEW OF FINANCIAL INCLUSION SERVICES

9. SELF HELP GROUP

A self-help group (SHG) is a village-based financial intermediary usually composed of 10–20 local women. Most self-help groups are located in India, though SHGs can also be found in other countries, especially in South Asia and Southeast Asia.

Members make small regular savings contributions over a few months until there is enough capital in the group to begin lending. Funds may then be lent back to the members or to others in the village for any purpose. In India, many SHGs are 'linked' to banks for the delivery of microcredit.

9.1.STRUCTURE

SHGs are member-based micro finance(having its origin in Bangladesh) intermediaries inspired by external technical support that lie between informal financial market actors like moneylenders, collectors, and ROSCAs on one hand, and formal actors like micro finance institutions and banks on the other. Other organizations in this transitional zone in financial market development include CVECAs and accumulating savings & credit association ASCAs.

Self-Help Group may be registered or unregistered. It typically comprises a group of micro entrepreneurs having homogenous social and economic backgrounds; all voluntarily coming together to save regular small sums of money, mutually agreeing to contribute to a common fund and to meet their emergency needs on the basis of mutual help. They pool their resources to become financially stable, taking loans from the money collected by that group and by making everybody in that group self-employed. The group members use collective wisdom and peer pressure to ensure proper end-use of credit and timely repayment. This system eliminates the need for collateral and is closely related to that of solidarity lending, widely used by micro finance institutions. To make the book-keeping simple enough to be handled by the members, flat interest rates are used for most loan calculations.

9.2 GOALS

Self-help groups are started by non-profit organizations (NGOs) that generally have broad anti-poverty agendas. Self-help groups are seen as instruments for a variety of goals including empowering women, developing leadership abilities among poor people, increasing school enrolments, and improving nutrition and the use of birth control. Financial intermediation is generally seen more as an entry point to these other goals, rather than as a primary objective. This can hinder their development as sources of village capital, as well as their efforts to aggregate locally controlled pools of capital through federation, as was historically accomplished by credit unions.

9.3 ADVANTAGES OF FINANCING THROUGH SHGS

An economically poor individual gains strength as part of a group. Besides, financing through SHGs reduces transaction costs for both lenders and borrowers. While lenders have to handle only a single SHG account instead of a large number of small-sized individual accounts,

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borrowers as part of an SHG cut down expenses on travel (to & from the branch and other places) for completing paper work and on the loss of workdays in canvassing for loans.

10. POVERTY ALLIEVATION

Poverty occurs in both developing countries and developed countries. While poverty is much more widespread in developing countries, both types of countries undertake poverty reduction measures. Poverty has historically been accepted as inevitable as non-industrialized economies produced very little while populations grew almost as fast making wealth scarce. Geoffrey Parker wrote that "In Antwerp and Lyon, two of the largest cities in western Europe, by 1600 three-quarters of the total population were too poor to pay taxes, and therefore likely to need relief in times of crisis." Poverty reduction, or poverty alleviation, has been largely as a result of overall economic growth. Food shortages were common before modern agricultural technology and in places that lack them today, such as nitrogen fertilizers, pesticides and irrigation methods. The dawn of industrial revolution led to high economic growth, eliminating mass poverty in what is now considered the developed world. World GDP per person quintupled during the 20th century. In 1820, 75% of humanity lived on less than a dollar a day, while in 2001, only about 20% do.

Today, continued economic development is constrained by the lack of economic freedoms. Economic liberalization requires extending property rights to the poor, especially to land. Financial services, notably savings, can be made accessible to the poor through technology, such as mobile banking. Inefficient institutions, corruption and political instability can also discourage investment. Aid and government support in health, education and infrastructure helps growth by increasing human and physical capital.

11. ECONOMIC DEVELOPMENT

Economic development generally refers to the sustained, concerted actions of policymakers and communities that promote the standard of living and economic health of a specific area. Economic development can also be referred to as the quantitative and qualitative changes in the economy. Such actions can involve multiple areas including development of human capital, critical infrastructure, regional competitiveness, environmental sustainability, social inclusion, health, safety, literacy, and other initiatives. Economic development differs from economic growth. Whereas economic development is a policy intervention endeavor with aims of economic and social well-being of people, economic growth is a phenomenon of market productivity and rise in GDP. Consequently, as economist Amartya Sen points out: “economic growth is one aspect of the process of economic development.”

The University of Iowa’s Center for International Finance and Development states that:

'Economic development' is a term that economists, politicians, and others have used frequently in the 20th century. The concept, however, has been in existence in the West for centuries. Modernization, Westernization, and especially Industrialization are other terms people have used when discussing economic development. Although no one is sure when the concept originated, most people agree that development is closely bound up with the evolution of capitalism and the demise of feudalism.

12. FINDINGS

- Considerable gap between demand and supply for all financial services.
- Majority of poor are excluded from financial services. This is due to, inter alia, the following reasons:
- Bankers feel that it is risky to finance poor people's because of their creditworthiness.
- High transaction costs.

13. CONCLUSION

With a view to evolving supplementary credit strategies for reaching the unreached rural poor in the rural areas micro finance innovations are yielding results and giving hope to the millions of poor through providing credit. In other words, micro finance is a programme for the poor and by the poor to mobilize the savings and use them to meet their financing needs. Thus, micro financing is a new method to meet the credit requirement in rural areas. In other words, there is need to evolve an informal credit system with assistance from financial institutions. Though the size of credit is very small for the target users, like micro entrepreneurs and low income households to utilize the fund for income generation and enterprise development and is also for community use, with the nominal terms and conditions and easy to understand with the help of SHGs and banks. There is now mounting hope that micro finance can be a large scale poverty alleviation tool. Banks too are shedding their old reluctance to lend to the poor and are looking to tap the expertise of micro credit groups to create a new market.

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