Role of Microfinance in Poverty Eradication in India

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Abstract— **Attention around the world in recent years has been focused on microfinance and its untapped potential in developing countries like India, Bangladesh, and Nepal etc. Therefore in present paper attempt has made to study the of role of microfinance in the eradication of poverty with the help of Indian government, Self help groups, World Bank and developed nations. The microfinance organization has founded research in last three years ago that microfinance as not just a viable but also profitable financing vehicle that traditional lenders like banks had previously underestimated. It is also found that the microfinance institutions (MFIs) reduce the resistance from governments and banks in the implementation of poverty eradication program me.**

Keywords*— *Micro Finance Institution(MFI), National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) , Asian Development Bank (ADB), Microfinance Management Institute (MAFMI) , Poverty Reduction Strategy Papers (PRSPs) , Consultative Group to Assist the Poor (CGAP), College of Agricultural Banking (CAB),Reserve Bank of India(RBI), Micro-Credit Ratings International (M-CRIL),Self Help Group(SHG), Self Employed Women's Association (SEWA), Millennium Development Goals (MDG) Introduction

Introduction

Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women's Association ("SEWA") of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganized sector in Ahmadabad City, Gujarat. The microfinance sector went on to evolve the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. From humble beginnings, the sector has grown significantly over the years to become a multi-billion dollar industry, with bodies such as the Small Industries Development Bank of India and the National Bank for Agriculture and Rural Development devoting significant financial resources to microfinance. Today, the top five private sector MFIs reach more than 20 million clients in nearly every state in India and many Indian MFIs have been recognized as global leaders in the industry.

In India, the history of rural finance is typified by the image of nationalized banking system which has failed to deliver credit and, if it has, not been able to recover it. Microfinance, by contrast, is increasingly being seen as an innovation in lending and the panacea for rural India's indebtedness to money lenders. The recent focus on microfinance in India marks a paradigm shift in orientation. The recipients of state-sponsored subsidized loans in the early 1980's, 75 million poor households today have become the driver of new assets. While no accurate estimate of the size of the Indian microfinance market exists, M-CRIL (Micro-Credit Ratings International), a leading micro credit rating agency based in Gurgaon, puts the estimated demand at Rs.

480 billion ($10.7 billion). That is calculated for 60-70 million households at an average household credit demand of Rs. 8,000 (less than $200).

Global Acceptance of Microfinance

The universal appeal of microfinance stemmed from its ability to reach the poor without social collateral and generation of near full recovery rates through what has been described as a Win-Win proposition. The mainstreaming of microfinance worldwide and its global acceptance in development community is based on this Win-Win proposition. This concept of provision of sustainable financial services at market rates has been termed as 'Financial System' approach or 'Commercial microfinance'. It is claimed that this new paradigm of unsecured small scale financial service provision helps poor people take advantage of economic opportunities.

Role of Indian Government

The Reserve Bank of India's training arm (RBI), the College of Agricultural Banking (CAB), made me think a fair amount about government's role in microfinance. Undoubtedly, India's government has played a large promotional role in Indian microfinance. The creation and growth of self-help groups through NABARD funding is quite impressive. Since the early 1990's, over 20 million Indian women have received credit through the government's SHG programme. At the same time, the fastest growing segment of microfinance, private microfinance institutions, does not seem to receive much government support (or that much regulatory supervision for that matter).

Accordingly, I am doing a little research on the role of government typically plays in microfinance. CGAP has an interesting piece that provides examples of government practices in several nations (e.g., Bosnia, Armenia, and Brazil), which points out those governments often play 3 different types of roles

1) Protector - The article argues that governments should develop appropriate regulations, or adapt existing banking regulations, to protect the solvency of large institutions that collect deposits from poor people. (In India, the government has largely not played much of a protector role. One reason may be that private MFIs are not allowed to take in formal savingsdeposits.)

2) **Provider** –The college of Agricultural Banking argued to Indian government By using public sector funds that did not go to the priority sector designees (e.g., agriculture, low-income households) to finance self-help groups, India's government created the foundation for microfinance.

3**) Promotional** - This could include financing or creating policies that facilitate the growth of microfinance. Going with my points above, I think (and the CGAP piece points out) that India's government does do a lot to finance the sector. On the policy side, there is room further improvement.

With regards to policy in India, in March of 2007 the Union Government introduced the Micro Financial Sector Development and Regulation Bill 2007 in the Lok Sabha – the lower house in the parliament of India. To this point, the bill has not been signed or rejected; I believe it still sits in the Lok Sabha.

The Roal of private sector

Microfinance in India is currently being provided by three sectors: the government, the private sector and charities. These three sectors, as large as they are, have only a small fraction of the capital and geographic scale required to meet the overwhelming need for finance amongst India's rural poor. The top 10 private sector microfinance providers in India together serve less than 5% of the unbanked population of India – approximately 20 million clients. example, SHARE Micro fin Limited ("SHARE") and Asmitha Micro fin Limited ("Asmitha"), two of the five largest MFIs in India, have almost Rs 4,000 crore ($900MM) loaned to over 5 million poor women in 18 Indian states (prior to the crisis, the combined outstanding loan portfolio had been as high as Rs 6,750 crore ($1.525BN)). Yet, despite the size of MFIs like SHARE and Asmitha, only a fraction of the overwhelming need is being met. Private sector MFIs have an essential role to play if the goal of financial inclusion is to be realized, as neither the government nor charities have the capital nor business model required to meet the insatiable demand for finance in rural

India. As the public listing of SKS Microfinance underscored, private sector institutions are able to attract increasingly large amounts of private capital, in order to accelerate the growth of the industry, which is essential to expanding financial inclusion as far and as fast as practicable.

Role of World Bank

Former World Bank President James Wolfensohn said "Microfinance fits squarely into the Bank's overall strategy. As you know, the Bank's mission is to reduce poverty and improve living standards by promoting sustainable growth and investment in people through loans, technical assistance, and policy guidance. Microfinance contributes directly to this objective".

The emphasis on microfinance is reflected in microfinance being a key feature in Poverty Reduction Strategy Papers (PRSPs) 14 realizing the importance of microfinance; World Bank has also taken major steps in developing the sector. Formation of Consultative Group to Assist the Poor (CGAP) in 1995 as a consortium of 33 Public and private development agencies and establishment of Microfinance Management Institute (MAFMI) in 2003 are significant landmarks. CGAP acts as a "resource center for the entire microfinance industry, where it incubates and supports new ideas, innovative products, cutting-edge technology, novel mechanisms for delivering financial services, and concrete solutions to the challenges of expanding microfinance".15 MAFMI was established with support of CGAP and Open Society Institute for meeting the technical and managerial skills required for microfinance sector. CGAP has been instrumental in shaping the dominant theoretical orientation of microfinance. The guiding philosophy behind diverse sphere of CGAP activities by way of dissemination of microfinance best practice, grant-making to Micro

Role of Regional Bank

Other Regional multilateral development banks like Asian Development Bank also champion the cause of commercial microfinance. ADB outlining its policy for microfinance lends support to the logic by saying "to the poor, access to service is more important than the cost of services" and "the key to sustainable results seems to be the adoption of a financial-system development approach". The underlying logic offered in support of this is universally based on twin arguments i.e., a) subsidized funds are limited and cannot meet the vast unmet demand, hence private capital must flow to the sector and b) the ability of the poor to afford market rates. Though, various scholars like Morduch have brought out the flaws of this Win-Win proposition like belief in congruence between commercial microfinance and poverty outreach, this paper will limit itself to analyzing as to how the focus on commercialization has relegated impact assessment to backstage.

India is a founding member of ADB and its fifth largest shareholder. Since the beginning of lending operations in 1986, ADB has approved 159 loans (sovereign and non-sovereign) amounting to $24,122.7 million. As of 31 December 2010, the portfolio included 67 ongoing sovereign loans amounting to $10.2 billion, with $3.7 billion going to transport, $1.3 billion to water supply and other municipal infrastructure and services, $2.5 billion to the energy sector, $1.05 billion to the finance sector, and $0.2 billion to the agriculture and natural resources sector.

Conclusion

The Indian economy at present is at a crucial juncture, on one hand, the optimists are talking of India being among the top 5 economies of the world by 2050; Landon the other is the presence of 260 million poor forming 26 % of the total population. The enormity of the task can be gauged from the above numbers and if India is to stand among the comity 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 achievement of the MDG of halving the population of poor by 2015 as well as achieving a broad based economic growth also hinges on a successful poverty alleviation strategy. 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. It seems that India's microfinance cup is half-empty, with more room for demonstrable participation by the public sector and foreign funds. It is also necessary that state-owned financial institutions such as the National Bank for Agriculture and Rural Development (NABARD) and the Small Industries Development Bank of India (SIDBI) could play a more active role in providing risk capital to new MFIs. "A mental block on their part is encouraging foreign funds to take advantage of the opportunity," It may be concluded that "India does not need only the small change that [foreign] venture funds are bringing in. but also changes in regulation are needed to create an environment conducive to tap the huge domestic resources that are available.

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