Is Microcredit a Tool for Poverty Alleviation?

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Abstract

Since 1990s, the focus on poverty eradication has resulted in achievement of goal of overall economic development of nation. To reduce poverty especially in developing countries, Microfinance works as an effective tool for poverty alleviation. Within this framework, various initiatives have been taken by NABARD in the form of MFIs, SHGs (Self Help Groups), NGOs and Government bank linkage program to lessen the poverty by providing micro financial instruments such as Microcredit and micro insurance are dealt with. Microfinance institutions through a number of services can enable the poor to smoothen their livelihood, manage their risks better, utilize their skills, build their assets gradually, develop their micro enterprises, enhance their income earning capacity, and enjoy an improved quality of life. "In this article, we suggest how poverty reduction can be achieved through alleviation measures that enable the poor to avail the credit facilities that include not only money to invest in a business but also consulting services to help the business succeed."

Introduction

"Poverty Alleviation: Universally accepted critique is that "poverty is the worst form of violence." Poor hence have little to offer by way of security against credit that might be extended by the micro-finance institution. Traditional banking sector cannot reach millions of poor for whom small loans could make huge differences as most of the poor reside in rural areas and are much dispersed. They have low education levels. Administrative cost of supplying loans to the poor population in rural areas becomes extremely high. Another issue that makes it difficult to serve these customers through traditional banking is that the poor does not have any assets to use as collateral. As a result, the poor had access to loans only through local money-lenders at exorbitantly high interest rates.

Microfinance has been in existence in the world since centuries but it is taken a formal form in different parts in globe at different points of time in the past century.

Microfinance starts with the assumption that the poor is willing to pay low interest rates to have access to finance. In general, the system uses the social trust as the collateral. Although there are different micro-credit financing models, the borrowers in the pioneering models are usually members of small groups. Loans are given to individuals, but an entire group is responsible for the repayment. Hence, the borrower who does not fulfil his commitment to repay back will lose his/her social capital. Micro-credit institutions report that their repayment rates are above the commercial repayment rates, sometimes as high as 97%. Today, there are millions of poor people around the world who turn to be entrepreneurs through the micro-credit sector.

The UN Millennium Project identifies micro-credit as "one of the development strategies… that should be implemented and supported to attain the bold ambition of reducing world poverty by half." A powerful endorsement of the importance of the micro-finance has come from the United Nations with the designation of 2005 as the International Year of Micro-credit. One of the most prestigious awards in the world, Nobel Peace Prize was given to Muhammad Yunus for his pioneering role in the development of the micro-credit sector.

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Although micro-credit financing is considered as one of the most powerful tools for combating poverty, the sector still faces several serious problems. Despite high repayment rates, the cost of operating micro-credit financial institutions is much higher than their traditional commercial counterparts. These institutions are usually charge excessively high interest rates to cover the high administrative costs of the micro-loans they offer to the poor people. This reality creates a tension between sustainability of the micro-credit sector and the outreach. It also makes it a challenge to regulate micro-finance institutions.

About Microcredit

Microcredit is a one of the financial perspective by which very poor people can take it from various related sources only in form of small loans for self-employment projects that generate income, allowing them to care for themselves and their families.

Microcredit is the extension of small loans to entrepreneurs too poor to qualify for traditional bank loans. It has proven an effective and popular measure in the ongoing struggle against poverty, enabling those without access to lending institutions to borrow at bank rates, and start small business. Microcredit is combination of two words i.e. Micro & Credit that includes the issues depict in **Figure I.**

Hence microcredit is not only the solution, but also a menu of options and enablement, that has to be put together, a-la-carte, based on local conditions and needs.

With the current explosion of interest on microcredit issues, several developmental objectives have come to be associated with it, besides that of only "credit". Of particular importance is savings - as an end in itself, and as a guarantee for loans. Microcredit has been used as an 'inducer' in many other community development activities, used as an entry point in a community organizing program and as an ingredient in larger education/training exercises.

An interesting stand is taken by the Virtual Library on Microcredit itself - it takes microcredit beyond the confines of 'money' and declares in its conceptual framework that:-

"Microcredit" is as much about money as it is about information. With sustainability and non-dependence on external resources being key to the growth of microcredit programs, the main focuses on providing pertinent and timely information in the form of strategies, tools, ideas and guide, to grassroots and intermediary organizations, and at the same time, educating the larger public on broader issues related to microfinance and microcredit.

Different from Microfinance

Micro finance refers to the provision of financial services to micro-entrepreneurs and small businesses, which don't who easy access to banking and related services due to the high transaction costs associated with serving these client categories. These institutions commonly tend to use new methods developed over the last 30 years to deliver very small loans to unsalaried borrowers, taking little or no collateral. In addition to these loans, organizations also provide consultancy services and technical support to their clients for better utilization of borrowing amount. These methods include group lending and liability, pre-loan savings requirements, gradually increasing loan sizes, and an implicit guarantee of ready access to future loans if present loans are repaid fully and promptly.

Micro credit means more emphasis on loans while micro finance also includes support services where you open up channels for thrift, market assistance, technical assistance, capacity building, insurance, social and cultural programs.

So where micro finance is 'Credit +', there micro credit is 'only credit'.

Microcredit and microfinance is not the answer to all the problems of poverty in developing countries, but it is indeed an 'inducer' to a great many actions that can lead to a better quality of life for the low-income groups.

Principles of Micro Credit

Microcredit is based on a separate set of principles, which are distinguished from general financing or credit.

- Microcredit emphasizes building capacity of a micro-entrepreneur.
- Employment generation
- Trust building

- Help to the micro-entrepreneur on initiation and during difficult times.
- A tool for socioeconomic development.

Different Models of Microfinance

In this section, two models of microfinance involving credit linkage with banks are discussed :

- SHG - Bank Linkage Model : This model involves the SHGs financed directly by the banks viz., CBs (Public Sector and Private Sector), RRBs and Cooperative Banks.
- MFI - Bank Linkage Model : This model covers financing of Micro Finance Institutions (MFIs) by banking agencies for on-lending to SHGs and other small borrowers.

Strengths of Micro-credit

In the past few years, savings-led microfinance has gained recognition as an effective way to bring very poor families low-cost financial services. For example, in India, the National Bank for Agriculture and Rural Development (NABARD) finances more than 500 banks that on-lend funds to self-help groups **(SHGs)**.

Self-help Groups

SHGs comprise twenty or fewer members, of whom the majority is women from the poorest castes and tribes. Members save small amounts of money, as little as a few rupees a month in a group fund. Members may borrow from the group fund for a variety of purposes ranging from household emergencies to school fees. As SHGs prove capable of managing their funds well, they may borrow from a local bank to invest in small business or farm activities. Banks typically lend up to four rupees for every rupee in the group fund. Groups generally pay interest rates that range from 30% to 70% APR[10], or 12% to 24% a year, based on the flat calculation method.

Nearly 1.4 million SHGs comprising approximately 20 million women now borrow from a bank, which makes the **Indian SHG-Bank Linkage model** the largest microfinance program in the world. Similar programs are evolving in Africa and South-east Asia with the assistance of organizations like Opportunity International, Catholic Relief Services, CARE, APMAS and Oxfam.

Microfinance also helps in the development of an economy by giving everyday people the chance to establish a sustainable means of income. Eventual increases in disposable income will lead to economic development and growth. According To NABARDs annual report 2011-12. Refer Table I.

Financial Support and Promotional Efforts by Nabard

Refinance Support to Banks

NABARD provides refinance support to banks to the extent of 100 per cent of the bank loans disbursed to SHGs. As per the data provided in NABARD annual report 2009-10 the total refinance disbursed to banks against banks' loans to SHGs during 2009-10 was ‘ 3173.56 crores, registered a growth of 21.1 per cent from ‘ 2620.03 crores in 2008-09.

Promotional Support - SHG-Bank linkage

- **Micro Finance Development and Equity Fund:** To strengthen the efforts of NABARD towards promotional support for micro finance, the Government of India in the Union Budget for 2010-11 had further increased the corpus of Micro Finance Development and Equity Fund (MFDEF) to 400 crore. Recognizing the need for upscaling the micro-Finance interventions in the country, the Hon'ble Union Finance Minister, while presenting the budget for the year 2000-01, had created Micro Finance Development Fund (MFDF) with an initial contribution of ‘ 100 crore, to be funded by Reserve Bank of India, NABARD and commercial Banks in the ratio of 40:40:20.
- **Training and Capacity building:** NABARD continued to organize / sponsor training programs and exposure visits for the benefit of officials of banks, NGOs, SHGs and government agencies to enhance their effectiveness in the field of microfinance. Training supplements and materials were supplied to banks and other agencies. Best practices and innovations of partner agencies

were widely circulated among government agencies, banks and NGOs.

- **Joint liability Groups:** Based on the studies conducted by NABARD, it was found that financing of Joint Liability groups (JLGs) is a good business proposition. It needs simplified documentation, group dynamics, timely repayment culture and prospects of credit enhancement to quality clients.

- **Micro Enterprise Development Program for skill Development:** The Micro Enterprise Development Program (MEDP) was launched by NABARD in March 2006 with the basic objective to enhance the capacities of the members of matured SHGs to take up micro enterprises through appropriate skill up gradation / development in the existing or new livelihood activities both in farm and non-farm sectors by way of enriching knowledge of participants on enterprise management, business dynamics and rural markets.

- **Grant support to Partner Agencies for Promotion and Nurture of SHGs:** NABARD continued its efforts in the formation and nurturing of quality SHGs by means of promotional grant support to NGOs, RRBs, DCCBs, Farmers' Clubs and Individual Rural Volunteers (IRVs) and by facilitating capacity building of various partners, which has brought impressive results in the promotion and credit linkage of SHGs.

The Brighter Side of Micro-Credit

- **Capitalism:** The proponents of Micro Credit tried to establish the theory that capitalism can work for the rich as well as for the poor. They introduced the micro-credit program as something purely non-political but economic in nature and free from class bias. But can the economic measures be ever politics-class-neutral? If not, then, is the micro-credit program projected as an effective tool of poverty alleviation, an exception?

- **Unemployment Reduction:** The threatening problem of unemployment marks the present scenario. The agriculture sector ceases to generate new job opportunities. Employment of workers in the manufacturing sector is cut down to a minimum to ensure more surpluses. The commodity market is facing recession. The service sector alone cannot absorb all who are refused employment elsewhere. When new investment opportunities in any of the three major sectors of the economy are woefully low, capital finds out its new ally in finance capital to utilize the accumulated surplus at its disposal.

- **Growth of Finance and Banking Capital:** The recent phase of capitalism witnesses growth of finance and banking capital. Earlier the businesses of banks and other financial institutions were urban-centric and elite-biased. Of late they target the poor living in the remote hamlets. Lending money to them ensures higher repayment and lucrative return. The rural poor, comprising of the majority of the global population who have been exploited by the usurers, became the easy prey of the micro-credit operators. They are brought into the micro-credit net. The United Nations Conference on Trade and Development (UNCTAD) reported the following in 1998 on the eve of Tripartite Meeting on Micro Finance in Lyon, France:

  The micro-credit phenomenon has revealed the existence of a huge potential market, profitable yet largely untapped: an estimated 500 million micro entrepreneurs and their families, until now largely excluded from a financial system….These 500 million micro entrepreneurs represent a potential credit market of US $ 100 billion and even larger market for savings and insurance.

- **Profit Motive:** The hunt for profit has motivated the micro-credit operators to target the unemployed poor. Micro Credit, proudly advertised as a tool of poverty alleviation, is merely a lip-service to them. Micro Credit, to them, is a newly invented tool of making profit. They look upon it is as business. Micro-credit operators are money-lenders. Neither is they the 'holy magi' nor is the Micro Credit their 'gift'.

The Darker Side of Micro-credit

- **Does not Reach the 'Hard Core Poor'**

  It is now well documented by the mainstream organizations such as the World Bank that 'hard core poor', who account for about 50% of the poor population, or about 30 million people, are not reached in substantial numbers by micro-credit schemes. That is, if we talk about poverty alleviation, the micro-credit schemes are not even addressing the hard core poor in the first place. Although micro-financing does not talk about collateral, they are definitely concerned about the creditworthiness in terms of repayment capability. The poor must repay, other wise they are no good.

- **Rate of Interest**

  The rate of interest charged in the micro finance sector depends on the cost of funds, cost of delivery of credit, cost of collection and payment, cost of providing for bad debts and profit margins. At present, the rate of interest charged is between 21 to 30%. The sustenance and economic viability of micro finance organizations depend on charging interest at the rate of 21-24%. Sa-Dhan, (an association of MFIs) has laid down model mutual Code of Conduct for Micro Finance Institutions. It advocates interest rate of 21-24%. The sector as a whole has been criticized for charging rates higher than the prevailing formal banking sector rates. To counter the criticism of high interest rates there is an urgent need for creating awareness about the need for charging cost-recovering interest rates.

The Challenges of Microcredit

- **Sector Slowdown due to the Global Economic Crisis**

  The global economic downturn has had its effect on the Indian microfinance institutions as well. This is particularly true for smaller MFIs that have experienced a slowdown in obtaining credit from commercial banks. Smaller MFIs, who anyway had limited access to sources of funding, are finding it difficult to mobilize funding from banks. Faced with the banks' reduced willingness to lend on account of the global crisis, some MFIs have struggled to maintain liquidity and continue client loan cycles without interruption.

- **Capacity Building**

  Capacity building and improving understanding of techniques for improving microfinance management is the key to effective microfinance operations and eventually for achieving the prime objective of financial inclusion. In the recent past capacity building and investment in human resources in India have increased but the quality and quantity of such services do not necessarily match the current requirements of the sector.

  There is also the lack of specialized low cost agencies for providing customized capacity building to the field staff of MFIs. Field staff requirements have grown manifold due to the growth of the sector in recent years. The MFIs have, so far, relied on in-house and on-the-job training methods for this purpose but in the long run this may not be cost effective.

- **Micro-Credit Plus**

  One of the biggest challenge in development is the simultaneous development of investment potential and improvement of skill levels of the borrowers. As microcredit alleviates the credit availability problem, the need for improving the skill levels and market linkages of below poverty line families as small producers grows. Microcredit alone cannot be expected to be a universal remedy for all developmental problems. In some sense, its role is similar to that of credit in the general economy.

- **The Problem of Multiple Lending**

  With an increasing number of MFIs mushrooming in the Indian microfinance space and with the high growth rates of the large MFIs, there is an increased incidence of client over-indebtedness on account of multiple lending to them. Although there has not been enough research on the direct relationship of competition and over-indebtedness, it has been observed that the same clients are members of more than one MFI in many parts of the country. This could be leading to clients accessing more debt funds than they have the capacity to repay. Such observations have been made mostly in urban areas where there is a high density population and MFIs are able to achieve economies of scale. There is another aspect of efficiency in tracking loans, which is linked to competition and over-crowding.

Conclusion & Recommendation

It is evident from the analysis that mere good intention is not enough to ensure sustainable development and peaceful life. Any development intervention naturally generates multiple consequences along with the primary goal of helping the poor. The case has also been proved as true about of the micro-credit operations in Bangladesh. A prudent analysis would consider these negative consequences as unintended, and undesirable, too. Identification of the unintended as well as undesirable consequences is the first step to overcome these problems.

However, concrete strategies are needed to improve the performance of micro-credit in poverty reduction. NGOs need to ensure transparency of their operations in order to emphasis the welfare of people. The criteria of creditworthiness that renders micro-credit a failure in including all poor should be abandoned to embrace the norm of human security.

To avoid the unintended consequence of producing hardcore poverty, NGOs must develop social safety net for the borrowers (not only for the lenders by creating different coercive mechanisms to ensure loan repayment) so that they may not turn hapless in the face of natural disasters and thus preventing downward mobility of the borrowers. Most importantly, to prevent diminishing charity-orientation, NGOs must develop alternative strategies for income generation and fund raising for the organization's survival and be prepared to provide emergency services to destitute people without charge so that the moral basis of their existence- charity- is not hurt.

Finally, education is frequently recommended as a solution to all sorts of problems. It would recommend the same, but with less emphasis on rote learning and more on educating the young so they begin to question gender and other structural hierarchies very early in life.

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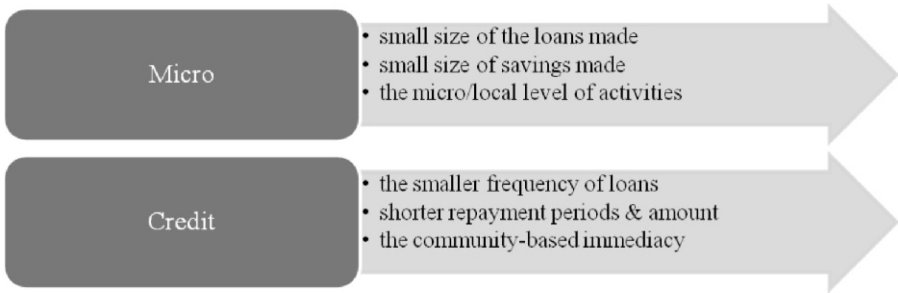

Figure I : Microcredit is Combination of Two Words Micro & Credit

Table I :According to NABARDs annual report 2011-2012

Purpose	Agency	No. of Schemes	Financial assistance	NABARD'S commitment	Disbursement during 2011-12	Cumulative disbursement as an 31st March 2012
SHGs	SCARDBs	-	124	124	124	292
	CBs	-	64542	64542	64542	685436
	SCBs	-	34421	34421	34421	203654
	RRBs	-	186848	186848	186848	930224
	ADFCs/PUCBs	-	21324	21324	21324	27747
	TOTAL		307259	307259	307259	1847353