



## Removal of poverty in India: Can microfinance alone do it?

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During the Post-War period many countries of Asia, Africa and Latin America realized that their political freedom could carry little significance unless it was accompanied by freedom from poverty and misery. These countries have witnessed an era of planning, social controls, nationalization and of late Liberalization, Privatization and Globalization (LPG). All these macroeconomic policies have been pursued in the name of development and also of course for the sake of poverty alleviation.

The problem of poverty has a little interesting history though it has never been interesting to its victims. In the name of poverty, poems have been written, plans have been formulated, slogans (e.g. Garibi Hatao) have been raised, elections have been won and subsequently voters have been duped. While writing the last page of his book Progress and Poverty in 1879 Henry George wept like a child. It was not the scarcity of resources, but the difficulties associated with the mobility of land, labour and capital which then generated poverty in the United States. The writings on North-South Dialogue inform that mass poverty in the South is the bottom of the stratified global social pyramid. The poverty of the poor is the wealth of the rich, nationally as well as internationally.

The problem of poverty in India has often been subjected to many statistical manipulations by some economists who have the knowledge of statistics and statisticians who have no knowledge of economics. Indeed, no other economic indicator has been so much miscalculated and misinterpreted as in the manner in which poverty estimation has been made. There is now a lot of

clamour on the need for raising the rate of economic growth for solving the problem of mass poverty and unemployment. While the consequences of poverty are felt and are perhaps intuitively understood everywhere and by all, the concept of poverty is still not crystallized nor its magnitude exactly known. The concept of poverty line is, therefore, more often than not elusive. In 1998, referring to the report of an expert committee headed by no less an economist than D.T.Lakadawala, it appeared that everyone agreed on the concept and method of estimation of poverty as recommended by the Committee. Yet subsequently experts arrived at diverse estimates, based on the very method of estimation. As-Gupta has cautioned, "The common man should be spared that statistical jugglery and should know that poverty is continuing at high levels and is not showing any sign of decline. This is especially so in the light of the fast rising prices of primary goods and unemployment and the fact that technology is becoming increasingly labour displacing". Now, when the brunt of inflation is being felt by all, and consequences of jobless growth and labour displacing technology are clearly visible, examining the achievements and limitations of microfinance programme as a poverty alleviation measure would be a rewarding exercise.

In his seminal paper Poverty Revisited published in 1996, Rath took pains to prove that the extent of rural poverty increased during the years following the LPG. For the protagonists of LPG, this finding was by no means pleasing. They have – with the

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help of data that suits their purpose – proved that there has been a reduction in the magnitude of poverty in India, thanks to the accelerated rate of growth during the LPG era. It appears that any person having a sound knowledge of statistics and even very little knowledge of economics can “prove” either an increase or decrease in the incidence of poverty. We are still waiting for a satisfactory measure of poverty. But the consequences of poverty never wait for anybody. In the famous Rio Summit, the report titled Sustainable Development: From Concept to Action was released which clearly described the consequences of poverty. India was one of the contributors to the concept that poverty removal and environmental concerns go together. It was admitted that poverty is the most severe pollutant in the world. Can micro finance emerge as an anti pollution measure in India by alleviating poverty? An attempt is made in this paper to examine this question.

History reveals that extreme poverty can dehumanize human beings. In the words of Galbraith, “Poverty is cruel: A continuing struggle to escape what is continuously frustrated is crueler”. In his view, the vicious circle of poverty is due mainly to the fact that the people in the poor countries, out of the experience of centuries, reconcile themselves to what has for so long been inevitable. Poverty can also corrupt man and absolute poverty like absolute power can corrupt absolutely. To examine the adequacy or otherwise of microfinance programmes in India, where absolute poverty is affecting many, is one of the objectives which this paper aims at.

The close connection between poverty and unemployment has been accepted by economists as well as policy makers. Among a few writers who highlighted the relation between poverty and inequality in a scientific manner, Amartya Sen gets a prominent place. His major contention is that one has to take into account the distribution of

income among the persons below the poverty line to measure the impact of poverty. We have Sen’s

### Poverty Index:

$$P = [I + (1 - I)G]H$$

Where P is the poverty index, I is the measure of distribution, G is the Gini co-efficient, and H is the head count proportion of the people below the poverty line. It is only when the income disparity is reduced, that it is possible to raise a considerable number of people above the poverty line. Poverty is conceptualized by Sen as a state of capability deprivation. In the very concept of poverty Sen indicates its impact. Statistical measures relating to poverty line cannot do this. Poverty, inequality and unemployment frequently constitute a triangle in the Indian society which is very much stratified. Sen also believes that microfinance can serve as an effective poverty alleviation measure in such a society.

Among the developing countries, India has abundant data on poverty alleviation programmes which were launched with the commencement of the planning process. There have been sector-specific as well as area-specific programmes. There have been nation-wide programmes as well as region-specific programmes. The outcome of all these programmes is ably summed up in the observation: “Poverty is dead, long live poverty!” It may be appropriate to see whether there is any likelihood of microfinance programme joining the tribe of other poverty alleviation programmes many of which look like punctured balloons.

Poverty in India – if not the poor – may continue to have a bright future. A reference may be made to an article “Another Dandi March, Another Gandhi” published in The Hindu Business Line (April 6, 2005) and there was a thought-provoking response to it in a letter to the editor (April 14, 2005) by A. Jacob Sahayam. He has opined that another Dandi

March was not a bad idea if it could spark some of the same spirit of political freedom to win economic freedom. Then there was a hard hitting question: "Just as Gandhiji vowed that he would not return to Sabarmati Ashram until India achieved Independence, could we take a pledge that we will not have another Dandi at least till extreme poverty is eradicated"? If this is the feeling in a country which has witnessed unprecedented growth of microfinance institutions, it is necessary to probe the role that these institutions would play in future in solving the problem of widespread poverty which is arguably India's greatest shame.

The National Sample Survey has made some estimates of poverty for the year 2004-2005. According to the NSS data, there has been a decline in the proportion of those living below the poverty line (BPL). Twelve years ago 36 per cent of the population was officially classified BPL; in 2004-05, the latest year for which data have been released, the BPL figure has fallen to 22 per cent. Though doubts have been raised about the comparability of figures over time, the NSS firmly holds on to its conclusion of a decline in poverty. But the NSS survey suggests three worrisome aspects of the problem of poverty in India. First, the goal of eradication of poverty appears quite distant on the basis of current trends. Considering the rate at which poverty is declining at present, it is estimated that it will take over 35 years to eradicate poverty. The second aspect, which is linked to the first one, is the fact that the absolute number of poor is still large and quite sticky. Going by the current rates of population growth and reduction in poverty ratio, India could still have more than 22 crore people living below the poverty line in 2020. The third worrisome aspect is the reduced effectiveness of growth in tackling poverty. If one compares the pre-reforms (1983 to 1993-94) and post-reforms (1993-94 to 2004-05) periods, the growth rate has clearly accelerated in the latter period, but the rate of poverty reduction has slowed a bit. The estimates of poverty in India indicate that the

extent of poverty is more in rural areas than in urban areas. To ascertain whether and to what extent the aim of microfinance programmes of helping both the rural and the urban poor has been fulfilled in practice would be a fruitful effort.

Amarthya Sen in his celebrated work *The Argumentative Indian* admits that the IT revolution has resulted in new centres of technical excellence like Bangalore and Hyderabad. He hastens to add, "Yet even a hundred Bangalores and Hyderabad's will not, on their own, solve India's tenacious poverty and deep-seated inequality. The very poor in India get a small – and basically indirect – share of the cake that information technology and related developments generate. The removal of poverty, particularly of extreme poverty, calls for more participatory growth on a wider basis, which is not easy to achieve across the barriers of illiteracy, ill health, uncompleted land reforms and other sources of several societal inequality". Abundant is the evidence to show that the problem of poverty is even today menacing, notwithstanding variations in the estimates regarding its magnitude.

This paper seeks to assess the progress of the microfinance programme with emphasis on the growth of self help group movement. It does not intend to question the utility of the programme. However, it attempts to show that the limitations of the programme should be clearly understood as its successes are widely recognized. In the light of findings of various studies, the paper reaches the conclusion that euphoria generated about the microfinance movement may not lead us anywhere unless there are some important redirections in policies.

### **Micro Finance Conceived as a Poverty Alleviation Tool:**

The term microfinance which has a pride of place in the vocabulary of development practitioners, is being treated as one of the surest ways of meeting



the Millennium Development Goals by the United Nations. It has three components, thrift, insurance and credit. To emphasize the utility of microcredit as poverty alleviation measure the United Nations declared the year 2005 as the International Year of Microcredit. In the words of the U.N. Secretary General Kofi Annan, "The Year underscores the importance of microfinance as an integral part of our collective effort to meet the Millennium Development Goals. The challenge before us is to address the constraints that exclude people from full participation in the financial sector... Together, we can and must build inclusive financial sectors that help people improve their lives".

Yunus Mohammed, a professor of Economics and founder of Grameena Bank in Bangladesh is largely credited for establishing the world's foremost microfinance institution (MFI). It has been replicated almost throughout the Third World. According to him, if one can run a bank by mobilizing low cost deposit, lending money and getting it back after covering all costs and still make a profit resulting in eradication of poverty and unemployment, what more can one ask for? With a good deal of optimism this Professor viewed micro finance as a poverty alleviation tool. "

The NABARD Task Force suggested a working definition of micro finance 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 NABARD has been consistently treating microfinance as a poverty alleviation measure for which there is a distinct institutional structure.

The Microfinance Institutional Structure is at present having two distinct segments: a) Mainstream Microfinance Institutions and b) Alternative Microfinance Institutions. The National Agricultural Bank for Rural Development (NABARD), Small Industries

Development Bank of India (SIDBI), Housing Development Finance Corporation (HDFC), commercial banks, regional rural banks (RRBs), the credit cooperative societies, etc., are some of the mainstream financial institutions. The Alternative Microfinance Institutions are:

- NGOs which are mainly engaged in promoting Self Help Groups (SHGs) and their federations at a cluster level, and linking SHGs with banks, under the NABARD scheme;
- NGOs directly lending borrowers, who are either organized into SHGs or into Grameen Bank-style and centres. These NGOs borrow bulk of funds from Rashtriya Mahila Kosh (RMK) and Small Industries Development Bank of India (SIDBI) and such other donors;
- MFIs which are specifically organized as cooperatives, such as the SEWA Bank and various Mutually-Aided Cooperative Thrift and Credit Societies (MACTCS) in Andhra Pradesh; and
- MFIs, which are organized as non-banking finance companies, such as BASIX and SHARE Microfin Ltd., in Andhra Pradesh.

During the 1990s pioneering efforts were made by NGOs across the developing countries to show that the poor, particularly women, need and deserve small loans. They have also been consistently arguing that the traditional collateral may be unnecessary while financing the poor, that lending procedures may be designed to ensure that microcredit is practical and cost effective, and that lending to the poor could become financially sustainable. As shown in Table 1, the characteristics of microfinance gleaned from the literature are different from the conventional credit provided by traditional financial institutions, which fuel the quest for an appropriate regulatory

treatment and architecture. It is the Self Help Groups which are expected to act as prime facilitators for realizing the candid goal of alleviating poverty with microfinance.

### **SHGs and Support to the Poor:**

SHG is an unregistered group of less than twenty people (any structure of more than twenty has to be registered) from a homogeneous class who come together for addressing their common economic problems.<sup>29</sup> The salient features of SHG based microfinance are:

- Self selection which means the members of an SHG select their own members to form groups;
- Small and fixed savings at frequent intervals coupled with conditions like compulsory attendance in meetings, panel provisions to ensure timely attendance and commitment for savings etc.;
- Principle of 'savings first and credit later';
- Focus on women (as experiences have indicated that the women clients form active and participatory members of an SHG);
- Intra-group appraisal systems to ensure good credit management;
- Credit rationing to meet critical needs of members on a priority basis;
- Shorter repayment terms to facilitate faster recycling of funds;
- Market rates of Interest in the interest of all members of an SHG to cover all costs of credit;
- Progressive lending to drive home the idea that money has a time value and is a scarce resource;

- A multiple-eyed operation to enhance the levels of trust and openness in the SHG system.

All these salient features are accounting for the emergence of traditional as well as innovative models for delivering microcredit to the poor.

### **Credit Delivery Models for the Poor:**

1. **Model I :** Bank – SHG- Members. In this model the bank itself promotes and nurtures the self-help groups until they reach maturity.
2. **Model II:** Bank- Facilitating Agency-SHG- Members. Here groups are formed and supported by NGOs are government agencies.
3. **Model III:** Bank-NGO/ MFI- SHG-Members. In this model NGOs act as both facilitators and microfinance intermediaries, and have been found to federate SHGs into apex organizations to facilitate inter-group lending and larger access to funds.
4. **Model IV:** Bank /MFIs- Federations/ Community Based Organizations- SHG- Members.
5. **Model V:** Recently piloted by NABARD for facilitating formation of SHGs in areas where there are no NGOs. It uses the services of committed individual volunteers identified by the bank branches.

In all the above models the commercial banks and rural banks are expected to play an important role in providing financial services to the poor. Hence, there is a need to develop strong partnership among commercial banks, rural banks and SHGs. In recent years efforts have been made to forge linkages between cooperatives and SHGs with the fond hope that such linkages would lead to revival

of cooperatives and increased support to the poor. But the goal of reviving the cooperatives for supporting the poor has remained a distant dream, a fact to which we will return later.

### **Key Principles for Helping the Poor with Micro Finance:**

Some key principles of microfinance delivery were highlighted by the Consultative Group to Assist the Poorest (CGAP) in 2003. \* Since principles are accepted in the above-mentioned models, they are worth enumerating here:

1. Like everyone else, the poor need a range of financial services that are convenient, flexible, and affordable;
2. When poor people have access to financial services, they can earn more, build their assets better, and cushion themselves against poverty and external shocks;
3. Microfinance should be part of the country's mainstream financial system if it has to be effective. A financially sustainable institution can continue and expand its services over the long term.
4. Microcredit is not always the answer or best tool for everyone or every situation. Destitute and hungry people with no income or means of repayment need other kinds of support before they can make good use of credit; and
5. National governments should set policies that stimulate financial services for poor people at the same time as protecting deposits.

### **Progress of Microfinance in India:**

The SHG-Bank linkage programme has registered tremendous growth. The number of SHGs credit-linked to banks shot up from 255 as at end-March 1993 to 16.81 lakh as at end-March 2005. According to the data published by NABARD, at the end of March 2004, as many as 10,79,091 SHGs

had been linked and financed by the banks. The cumulative loans advanced by the banks aggregated Rs.3,904 crore. During 2003-04 alone, the banks financed 5,33,400 SHGs of which 3,61,731 were financed for the first time and 1,71,669 SHGs got repeat credit. The total number of families which got SHG cover was 1.67 crore. Ninety percent of the 10,79,091 SHGs were only 'women groups'.\* It would not be wrong to say that the linkage programme has contributed substantially towards the feminization of micro-finance banking in India.

The year 2004-2005 witnessed an explosive growth in micro-loan disbursements. \* A few examples may be cited here. Share Microfin Ltd, which came into existence in Hyderabad in 1993-94, has lent a sum of Rs.870 crore of which nearly 52% was given in 2004-2005. Another MFI, Spandana, has disbursed micro loans worth Rs.550 crore since its inception in 1998; Rs.350 crore of them was lent in the financial year 2004-2005. ICICI Bank's micro credit disbursements during 2004-2005 could cross Rs.700 crore – more than three times the amount disbursed in the previous year (2003-2004). HDFC Bank's disbursements during 2004-2005 were Rs.60 crore, while it was around Rs.30 crore in the previous financial year. In spite of this growth, there is still large scope for extending microcredit; one of the studies has revealed in 2004-2005 that the lending opportunity thrown up by microfinance was at Rs.45,000 crore a year, and against this, the entire financial sector has just lent about Rs.3,900 crore.

The 2005 Union Budget Speech by Finance Minister P.Chidambaram was considered as a landmark event in the history of Indian microfinance for bringing out some of its dimensions and addressing some of its requirements. He expressed his happiness over the progress of microcredit and said that the banks were well on their way to achieving the target set by NABARD to finance a third of India's rural poor through SHGs by 2007.

He reported that a cumulative Rs.4,000 crore had been disbursed to these SHGs of mostly poor rural women; an average amount of Rs.36,000 per group. If bare statistics is an indicator, this was not a trivial amount considering that the loans were unsecured and the SHGs involved were informal. The Finance Minister as the part of his vision for 2004-09, expressed the hope that an indicative target of credit linking 5.85 lakh SHGs during the period up to March 31, 2007 was set for NABARD, SIDBI, banks and other agencies. » He seems to have ignored the difficulties likely to arise with the expansion of the microfinance movement.

NABARD reported that due to the early start, as many as 6,75,356 SHGs were linked by March 31, 2004 in southern region consisting of Andhra Pradesh, Tamil Nadu, Karnataka, Kerala and Union Territory of Pondichery. This was followed by the eastern region consisting of 1,58,237 SHGs and the central region [U.P, M.P, Chhattisgarh and Uttaranchal] at 1,27,009 SHGs. By the end of March 2004 of the total SHGs linked, Andhra Pradesh accounted for 36 percent, Tamil Nadu 14percent, Karnataka 10 percent and Uttar Pradesh 7percent. The remaining states had only 33 percent of the total SHGs linked to the banks. NABARD has during the last 2-3 years made special efforts to accelerate the progress under the Linkage programme in Assam, Bihar, Chhattisgarh, Gujarat, Himachal Pradesh and Jharkhand. From the statement of the Union Finance Minister and the statements published by the NABARD from time to time, it appears that once again a target-oriented approach is being seriously pursued. » The experiences in connection with various poverty alleviation and employment generation programmes till date are instrumental in revealing that poverty refuses to quit this country where sheer target-oriented programmes have been implemented with thunderous claims and intensive propaganda. The best example was the unsung and unwept demise of IRDP.

### **Formidable Challenges of Phenomenal Growth of MFIs:**

The expansion of microfinance movement has, in some parts of the country, given rise to ticklish problems which could not be nipped in the bud. For instance, a study conducted by the Indian Bank's Special Unit for Micro-finance, Usilampatti, covering southern districts of Tamil Nadu, revealed that the identified factors having high risk are: clubbing too many government programmes, higher than required loan size, frequent switchover of the field staff, lack of monitoring, non-transparent deals devoid of good governance, etc, by the SHG/NGOs.» As a large number of activities are conducted through SHGs, quality has become the victim of quantity mainly because of the inadequate supervisory mechanism.

The further numerical growth of SHGs envisaged by the Union Finance Minister is likely to pose a big challenge, a fact which he and the NABARD seem to have not considered at this stage. There is a massive task ahead of training and strengthening the members of the SHGs so that they are in a position to grow organically, improve their accounting practices, increase their monthly savings, and avail of larger loans in successive rounds of borrowings from the banks. The NABARD may have to give due attention to this challenge in future and also of course in its annual statistics. Frustrated by high entry capital needs, the microfinance movement in India is proposing the enactment of a Microfinance Act which may provide for a separate fund called Vikas Nidhi with an initial capital of only Rs.25 lakhs and which may subsequently be allowed to raise deposits from the public. Strangely enough, Chidambaram showed a cold response to this demand of the movement in his address of the Conference on regulatory framework of MFIs held at Delhi on January 20, 2005. To quote him, "I do not see any compelling arguments for MFIs to become credit institutions and accept deposits. There are enough lendable



resources with banks. What is lacking is proper intermediation. You must examine whether intermediation could be your predominant role". » Does it mean that with the growth of microfinance movement, the role of MFIs will cease to be significant? With reduced significance of their role what great contribution can the MFIs make to the task of poverty reduction?

In one of their recent articles, Y. S .P. Thorat and others have examined the growth and achievements of microfinance movements all over the world in providing financial services to the poor. But in India, it is observed, the movement has a long way to go, as millions of low income people remain unable to access formal financial services. A very conservative estimate suggests that, at the most, only 20 percent of all the eligible low-income people have access to financial services from formal financial institutions, MFIs and other such stakeholders. With a note of optimism they say that the unparalleled banking infrastructure in India offers a significant opportunity to accelerate, deepen and improve the quality of access to financial services for the poor, and to develop an inclusive, sustainable financial system. Nevertheless, this optimism is soon followed by a word of caution. As they write, "There is a growing recognition that lack of human capacity remains one of the key barriers to developing full-fledged inclusive, sustainable financial system". Their paper closes with the disappointing observation that "Banking for the poor cannot be poor banking". » How can a financial system characterized by the lack of human capacity help the poor?

The day is not far off when the difficulties associated with poverty targeting may become much more conspicuous. NGOs and MFIs would have to have teams of dispassionate workers to handle all the five elements of poverty, viz., targeting strategy; identifying the poor; reaching the poor; attracting the poor; excluding the non-poor; and discouraging the non-poor. As things

stand today such experts are not in sight. The risks of poverty-targeting are coupled with other risks which would crop up with the implementation of Basel II norms with effect from 2007. In fact, today, the risk management in microfinance has assumed greater significance as banks are preparing to comply with the related Basel II norms. The portfolio of microfinance is primarily exposed to credit risk, which is nothing but default/diminution in the credit amount released and operational risk, which is the risk of loss resulting from inadequate or failed internal process, people and system or from external events. With the increase in the number and intensity of such risks it will not be unnatural if the MFIs distance themselves from the goal of helping the poorest among the poor with no collaterals to offer to back the loans taken by them.

### **The Continued Failure of Cooperatives to Help the Poor:**

The failure of credit cooperatives to help the poor in India has a history of its own. V.M.Dandekar once raised a serious objection against the phrase of the All India Rural Credit Survey Committee (1954) that "Cooperation has failed, but Cooperation must succeed". » He rightly stated the cooperative movement which was hit by a number of deep rooted diseases could not succeed even with the implementation of the recommendations of the Committee. The reports published by NABARD showed that up to March 2004, the commercial banks were at the forefront in the SHG-Linkage Programme. Of the total loans advanced under this programme of Rs.3904 crore, commercial banks accounted for 58 percent, the regional rural banks 33 percent and cooperatives a meagre 9 percent. The cooperative movement, part of the Nehruvian humanist-socialist agenda, actually lies in disarray. The Vaidyanathan Committee has made a number of recommendations by recognizing the moribund state of cooperatives. But these recommendations have been severely



resisted in many parts of the country. Cooperative credit is complicated by the dual control of the State Government and Reserve Bank of India. The Union Finance Minister has expressed his willingness for a Rs.15,000 crore cost of restructuring cooperatives. He wants democratization, corporatization and professionalisation which are difficult to be attained even if this entire amount is spent by way of reaching the target.<sup>24</sup> Cooperation between the rich and the poor is very difficult to achieve. Given the low savings and deposits, cooperative credit is inaccessible to the poor. Since the efforts to get rid of dual control are likely to get defeated, the cooperatives can hardly emerge as effective channels of microcredit necessary for removal of poverty.

Emergence of the microfinance movement was due to the failure of the cooperatives in providing sustained access to credit to the poor. The most significant change in the balance sheets of cooperative banks has been the decline in the rate of growth of deposits and loans and advances and these banks are deploying funds in investments. The pathetic condition of cooperative banks is that they become sick, the moment they start serving their clients! The structure that has the best outreach to rural India is not reaching out to its deserving clients.

It may be noted here that the cooperative credit institutions came to the SHG linkage programme as late as in 1996, due only to the result of NABARD's initiative. The growth of SHG linkage across cooperative credit institutions has been remarkably uneven. Harper has shown that the better-off southern states (Tamil Nadu, Andhra and Karnataka) have dominated the linkage programme, while the states in the poorer north and east of India have lagged behind.<sup>25</sup> It is pertinent to note that these are the very states where the linkage programme is so much more needed in the struggle against poverty. The same structural weaknesses which have constrained

development in these states have constrained SHG linkage also. After examining the spread of the cooperative-SHG linkage across states, the relationship between commercial success of cooperatives banks, the extent of the linkage established and the impact of such linkages on performance of cooperatives, Harper argues that primary agricultural credit societies and cooperative banks have thus far played a limited role in the programme of linking SHGs to formal financial institutions. The cooperative banks need SHGs more than SHGs need them! The cooperative credit institutions have, by and large, have failed to help the rural poor because they are not able to set their own house in order.

### **Limitations of Microfinance: Findings of Some Studies**

The key principles governing microfinance and different models of credit delivery to the poor have often been violated. The findings of some significant studies can be an eye opener:

1. Malcolm Harper and Manoj Nath found that in Jabalpur district of Madhya Pradesh there were many instances in which the distribution of loans amongst the members of the SHGs was far from equitable.<sup>26</sup> Inequity was found to exist in many programmes and activities of SHGs such as members' selection, amount saved, loan distribution and determination of interest rates. As Harper and Nath commented, "Inequity persists, within the nation, the states, the districts, the villages and even within the few SHGs which are in each village. This is not because of any evil genius of the Indian people, nor of the population of Madhya Pradesh or Jabalpur, but is the result of tendency that Marx observed: the rich get richer and the poor get poorer. We must search for the constraints to equity at every level, and try in every way possible to reverse the trend". To them it appeared that MFIs never worked with the poorest of the poor;

2. Rajesh Chakrabarti has studied the activities of an NGO in West Bengal, namely Bagaria Relief and Welfare Ambulance Society (BRWAS). "BRWAS was operating in the South 24 Parganas district of West Bengal with a microfinance programme along with other development programmes. He found that BRWAS was acting as a financial intermediary for as many as 265 SHGs. It had an ambitious mission which included bringing the poor and backward people into the mainstream of society by improving their socio-economic conditions; achieving socio-economic and political empowerment of women and removing gender inequality; helping every individual attain her fundamental rights; creating health, education and social consciousness among the poor and backward; protecting women and children rights; developing a fully literate, unpolluted and healthy society; and to develop agriculture by application of modern technology. Its focus groups consisted of deprived women, children and elderly people. No doubt BRWAS had the credit of functioning vigorously in realizing its goals but its practice of charging as much as 24 percent rate of interest on loans and 5 percent rate of interest on deposits was not helpful to the poor. Chakrabarti contends that in India too microfinance often eludes the "poorest of the poor" as elsewhere in the world;
3. Andhra Pradesh has been witnessing a remarkable growth in microfinance activities, accounting for about 40 percent of all SHGs in India. But some disappointing events in the recent past are revealing that MFIs here are heading towards a severe crisis. The Chief Minister of Andhra ordered in March 2006 an official enquiry into the affairs of the MFIs in Guntur, Krishna and Nalgonda districts. In a public meeting he went to the extent of saying that MFIs were turning to be worse than money lenders by charging interest rates in excess of 20 percent. Besides they were resorting to unethical ways of recovering loans by confiscating title deeds, using intimidation and abusive language, and combining multiple products like savings, insurance and loan to ensure recovery. The gravity of the situation could be understood from the fact that the district authorities in Andhra had to close down as many as 50 branches of two major microfinance institutions in the larger interest of the public. Analyzing the debacle of MFIs in Andhra Pradesh, Shylendra " expresses the apprehension that the future path of MFIs is bound to be crisis-ridden, similar to the one faced recently, unless they are enabled to come out of their structural constraints and from the influence of neo-liberal agenda;
4. The Decentralization and Development Unit (DDU) of the Institute for Social and Economic Change (ISEC), Bangalore undertook a field study of two NGOs from Andhra Pradesh and Karnataka covering the period 1995 to 1998-99. These NGOs were Grama Vikas and Sangha Mitra services society. The study focused attention on microfinance, poverty alleviation and empowerment of women. No doubt the microfinance programmes in the study areas have helped the rural poor to get an access to credit and enabled them to undertake income generating activities. But the study clearly listed the limitations of the programmes. As Rajashekar in his monograph (2004) observed, "However, the responsibilities such as development of economic infrastructure and providing bank finance to micro-finance groups must be undertaken by the government as the micro-finance programmes cannot alone alleviate poverty". Inadequate expenditure on the development of infrastructure has led to an infrastructure deficit in the country which in turn accounts for low rate of development and high level of poverty. In one of its historic

- judgements pronounced in October 1996, the Supreme Court has reminded the Centre, States and local bodies of their constitutional responsibility to provide basic infrastructure facilities to both the rural and urban poor in a phased manner in the annual budgets. » The MFIs in spite of whatever virtues they possess cannot fill up the infrastructure deficit. After all, the fact remains that a microfinance institution is like a living organism that reacts to its socio-economic environment, and its success depends on reacting most aptly to that environment. The MFIs may keep on reacting to the environment that the infrastructure deficit creates by perpetuating poverty, both in rural and urban areas;
5. Commenting on the status of the rapports built up by SHGs with banks, Malla Reddy has observed that only 50 percent of the SHGs developed good report with the banks, while 25 percent were functioning irregularly and the remaining 25 percent were non-functional in 2003. » The benefits of microfinance programmes could not be fully reaped as the short circuiting of the process of group formation resulted in malpractices like nepotism, differences among the group members under-mining the group solidarity and the untimely death of several SHGs. The findings of a study conducted by the Indian Institute of Public Administration supplemented Malla Reddy's comments;
  6. Namerta has made a study of income generating activities initiated for women in eight microfinance programmes across India with the objective of women empowerment.» The study concludes that less than 50 percent of the sample women borrowers were economically empowered or benefited from improved household decision-making due to micro-finance services. And more than 50 percent of the respondents lost control of the loans and incomes from the enterprises, as they were taken over by male family members. In any case, women empowerment should be interpreted to mean more than a marginal increase in the access to income and or concentration in limited areas of household decision making and or occasional meetings with a small group of other women. Unless empowerment is an integral part of the whole development process, the rapid expansion of microfinance is unlikely to make more than a limited contribution to empowerment and poverty alleviation;
  7. The risks of pushing microcredit as the strategy for poverty eradication are shown by David Hulme and Paul Mesley in their fascinating work *Finance against Poverty*. » Using insightful statistics, they have shown that the increase in income of microcredit borrowers is directly proportional to their starting level of income. The poorer they were to start with, the less the impact of the loan. One could live with the finding in an imperfect world, but what is really troubling is that a vast majority of those whose starting income is below the poverty line and actually end up with less incremental income after getting a micro loan as compared to a control group which did not get the loan. This should stop the converts from offering microcredit as other solution for poverty eradication since it seems to do more harm than good to the poorest;
  8. BASIX in its annual report for 2003-04 titled "Equity for Equity" demonstrates that in many cases, microfinance operations were characterized by inequity. » While banks have been engaged in financing small borrowers, the manner in which this is being done can hardly be called microfinance. The procedures are cumbersome, the staff unfriendly and transaction costs high. Repeat loans, except for crop production are rare even for borrowers



who have repaid fully. Furthermore, even though many of the loans extended to the poor by the public financial institutions are subsidized, their ultimate cost to the borrower is high: factoring in out-of-pocket costs, payment to middlemen and business loss due to time spent in getting the loan approved. Effectively, the total cost of fund to the borrower ranges between 30 percent as against 12.14 per cent, nominal lending rates for commercial bank loans below Rs. 20,000. All this resulted in low repayment rates, leading to a vicious cycle of non-availability and repayment resulting in additional problems for the poor; and

9. Vijay Mahajan's in his note "Is microcredit the answer to poverty eradication?" raises doubts about the capacity of micro finance in eradicating poverty. \* There are five fatal assumptions on which microcredit is based: i) that all the poorest wish to be self employed; ii) that credit is the main financial service needed by the poor; iii) that credit can automatically translate into eventful micro enterprises; iv) that those slightly above the poverty line do not need microcredit and giving it to them amounts to mis-targeting; and v) that all microcredit institutions can become financially self sustaining. More studies need to be carried out to find out the income and other impacts of microcredit before it is projected as a solution to the problem of poverty.
10. In India, MFIs are working with different environments and institutional structures with diverse categories of the clients and credit delivery models, with single (credit only) or multi-service (credit plus services) products, and with different pricing strategies. Therefore there could be disparity in the cost of services and recovery across the institutional structures. Since there is a trade-off between sustainability

and impact of microfinance programme across the diverse institutional structures, it is not surprising if the goal of poverty alleviation is attended to in a half-hearted and sketchy manner."

The foregoing studies are a pointer to the fact that mere taking the numbers of MFIs and SHGs to Olympian heights and vigorous pursuit of target hunting cannot help the country to fulfil the Herculean task of removal of poverty. If the limitations of microfinance programme are not deeply understood, whatever successes the programme has achieved would disappear, and the poor will remain poor because they are poor.

#### **Ailing Agriculture, Rural Poverty and Helplessness of MFIs:**

The problems like non-viability of the bulk of landholdings and low productivity in Indian agriculture. In recent decades some more diseases have attacked this sector already suffering from anaemia. The declining public investment since 1980s has generated a series of adverse effects on the future prospects of agricultural growth and also on the competitive strength of this sector at a time when India is a member of the Agreement on Agriculture designed by the W.T.O. While the share of agricultural sector in India's GDP is falling, the share of agriculture-dependent population in the total population has not been showing a significant declining tendency. In any case, the latter share has not declined to the same extent, as the share of agriculture in GDP. This means that people dependent on agriculture are getting increasingly impoverished, because they are having a declining share of GDP at their disposal, a state of affairs considered as a puzzling anomaly. \* The service sector, a small segment of the economy has contributed the largest share of GDP and thus enjoyed a spurt in jobs and incomes. But the farm sector which is a big segment of the economy with



a lowest growth in decades has the largest number of mouths to feed and few resources to do it with. Over 190 million rural people (i.e., more than 90 percent of the total rural BPL population) have no access to jobs. Indeed agriculture in India has become a parking lot of the poor. » To address the large class of small farmers steeped in poverty and underemployment is by no means a small task for MFIs, even if they take the risk of becoming generous beyond a point.

The falling incomes and rising expenses of cultivation have made a large number of farmers vulnerable. The Situation Assessment Survey (SAS) of the farming community commissioned by the Ministry of Agriculture and carried out by the National Sample Survey Organization have, a few months back, shown the dreadful condition of farmer households, be it in income, expenditure or indebtedness of farming households. Farmers have been committing suicide or eating rat meat! One of the SAS reports also indicates that given a choice, 40% of the farmers would quit agriculture and take up some other jobs. » Obviously, the MFIs cannot attend to such totally disheartening state of agriculture even if they pursue the pious goal of poverty alleviation.

The era of LPG is demanding from bankers an innovative approach on farm credit. The banking system should be geared more to financing the traditional crops like cereals, besides reorienting itself to meet the changing requirements of commercializing agriculture. Now the emphasis is on economies of scale in agriculture, corporate agriculture and corporate farming. As a result the small and marginal farmers are being marginalized. The banking institutions in rural India are called upon to account for what is called the lending conundrum because of their own practice of charging outrageous rate of interest on their loans and advances. An organic farmer in Madhya Pradesh once made a hue and cry because a tractor loan from a bank cost at 12 percent and finance for

a car around 9 percent.» The MFIs have to consider limits of credit while stipulating credit limits. The Khusro Committee (1989) pronounced the hard and cardinal truth, namely, 'In a poverty ridden economy, financial institutions do have a responsibility towards weaker sections, but it is essential to recognize the limitations of credit as the principal instrument of poverty alleviation'.» The impact of this truth is very much felt by MFIs also.

The experimentation with crop insurance and livestock insurance is not satisfactory because such schemes have not been able to prevent farmers' suicides in large numbers. That we have yet to devise a satisfactory method or institutional mechanism for evolving social insurance for the rural poor is a major lacuna in our anti poverty programmes. Even the MFIs or SHGs have not been successful in providing adequate social insurance, though some of them have made a modest beginning. There are several instances of rural households being mercilessly pushed below poverty line owing to the emergencies like the death of bread winner in the family. As Nadkarni observes, "The problem of financing the poor and particularly of meeting their emergency needs and providing social insurance remains thus unresolved in India, despite all the institutional developments during the last fifty years. Can professional financial wizards and social scientists take up this challenge and contribute to elimination of poverty in this country"? » Obviously he is drawing our attention to the limitation of microfinance as a poverty alleviation measure.

The limitations of micro credit programmes carried out in 1990s under various institutional arrangements run by NGOs and government organizations are also highlighted in The Report of Independent Commission on Banking and Financial Policy. (2006).The report, in the light of a study conducted out in Andhra Pradesh, notes with alarm the grave consequences of misuse of these credit programmes like extreme indebtedness, social

oppression and even suicides among the rural poor. The Report laments that besides the difference that exist with regard to the extent of coverage of the rural poor and the contribution of micro-credit to pulling its clients out of poverty, the common problems noted are: (i) excessively high rate of interest, hitting the poor; (ii) inability to reach the really poor in a financially viable way; (iii) donor dependence and (iv) financial non-sustainability. Some MFIs play an extremely damaging role in undermining the SHGs themselves, by using them as means to ensure high rates of recovery of credit provided at deplorably exorbitant rates of interest."

#### **Needed Redirections in Policies:**

Some policy measures and steps need to be taken on priority basis in order to realize the goal of poverty removal with microfinance: i) Policy reforms on savings, social insurance and women empowerment as a part of the whole planning process should be effected to create enabling policy environment for the poor ; ii) Products and services of NGOs and MFIs should be diversified to fulfil the felt needs of the poor communities ; iii) Innovative programmes and appropriate financial technology (financial engineering) by NGOs and MFIs to help the poorest of the poor should be devised; iv) NGOs and MFIs should set performance standards to compare their own achievements to these standards, and they should voluntarily encourage or undertake impact studies free from bias and prejudices especially at the grass root level with the specific object of estimating or measuring poverty reduction; v) Given the colossal task of poverty alleviation, there is an equally important need to nurture new MFIs who would require rigorous capacity building efforts; vi) Both NGOs and MFIs have to undertake continuous process of research and development (R & D) which will enable them in combating the practical constrains through lessons drawn from global finance service providers; vii) Both NGOs and MFIs have to encourage job-generating micro enterprises because it is proved beyond doubt that productive jobs are a key to

poverty reduction. If such enterprises are started even by those who are slightly above the poverty line, the MFIs should not shudder to extend their helping hand for realizing the goal of poverty eradication; viii) Since microfinance involves handling of a large quantum of public funds besides the trust of the poor segments of the society, there is a strong need for regulation. No doubt the overall responsibility of regulating MFIs should rest on the government or the central bank but care should be taken to see that the MFIs are not rigidly standardized or overregulated as they may lose the very rationale of their existence. It is time that an architectural layout for microfinance institutional network is formulated which should define the roles of different entities, viz., government, central bank, microfinance agencies, banking partner, rating agency, deposit insurance agency, promoter, capital provider, human capital building institution and, finally, MF clinets."

A word of caution has already been given in the State of the Micro Credit Summit Campaign Report for 2003. To quote, ".....In microfinance, we often use code words when we want to avoid talking about poverty. We say "outreach" or "depth of outreach" when we want to avoid direct reference to poverty: We say pro-poor but do not define, it or we define it, but we do not measure it. Human progress can best be measured by how we have found wrongs and corrected them, and how we have found injustices and made them right". Without such cautious approach and needed reorientation in the microfinance programmes, the talk of removing the poverty of the poor in India will only take them on a bridge that is not built and to the heavenly state of things that does not exist.

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**Table 1 Distinctive Features of Microfinance**

No	Characteristics	Description	Expected Result
1.	Type of Client	Low-income Employed in the informal sector or self - employed Lack of Physical collateral Interlinked household and micro enterprise activities	Credit to the poor
2.	Lending Technology	Group of individual loans Sample and minimal documentation Cash flow - and character – based Collateral substitutes, e.g. group guarantee, peer pressure, joint liability Repeat loans provided, short - term maturities	Group lending based on group guarantee and simple procedures to support the poor -
3.	Interest rates	Generally market, allowing MFI to cover costs and a margin of profit	Cost effectiveness of credit to the poor
4.	Loan Portfolio	Working capital, shortterm loans, repeat loans Few longer - term loans Clients mostly women	Diverse use of credit taken by the poor, particularly women
5.	Provider	NGOs Banks, adopting micro finance lending technology In some areas, cooperatives In others, government banks/ministries	Separate institutional framework to provide credit to the poor
6.	Institutional Structure	Decentralized If MFI is NGO, insufficient external control, dependent on quasi - equity capital (grants and soft loans) If MFI is bank or co - operative, regulated	Suitable governance of credit given to the poor
7.	Regulation/Supervision method	Limited to a subgroup of MFIs (Banks, for example) Secondtier institutions are commissioned Traditional vs, riskbased supervision NGOs left unregulated vs, plan for comprehensive regulation and supervision of all types of MFIs.	Regulation of MFIs to ensure poverty alleviation through microfinance.

**Note:** Based on information available in literature on micro finance.