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MICRO FINANCE AND DEVELOPMENT PARADIGMS

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Abstract: *Micro financing can be traced back to the middle of the 1800s when the theorist Lysander Spooner was writing over the benefits from small credits to entrepreneurs and farmers. Now we have many Nationalised bank's schemes as well as Non-Banking Financing Companies (NBFCs) contributing towards achieving the main objective "getting the people out of poverty." In this research paper, the researcher has discussed "Micro finance and development paradigms". Development banks, after their mushrooming in the 1960s are now one of the main channels for development finance. They have shifted their targeted and subsidized credit programs from industrial and infrastructure development towards small farmers and businesses and similar target groups. This paper compares development banking and microfinance, effects of microfinance and hurdles in microfinance. Researcher is of the view that group lending mitigates information problems, increases repayment rates and is therefore, a key factor in microfinance. In some countries it is already generating positive results. The study of the impact of microfinance and its holistic approach is discussed in this paper. The researcher has referred to secondary sources of data collection.*

Key Words: *Microfinance, Micro finance institutions, Development Banks, Microfinance Information Exchange (MIX).*

1. INTRODUCTION :

The history of micro financing can be traced back 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. However, the concept had a great impact at the end of the World War II with the Marshal plan. The term microfinancing has its roots in the 1970s. Mohammad Yunus, a social entrepreneur in Bangladesh established Grameen Bank of Bangladesh to initially provide small loans to entrepreneurs.

Although, microfinance has a long history from the beginning of the 20th century, the researcher has concentrated mainly on the period after 1960s. Shorebank was the first microfinance and community development bank founded in 1974 in Chicago. During the early and mid-1990s various credit institutions had been formed in Europe for poor people from both the rural and urban areas. These institutions were named Credit Unions, People's Bank etc. The main aim of these institutions was to provide easy access to credit to the poor people who were neglected by the big financial institutions and banks.

PERERA, Phillips (1968) states: The first financial corporations were established in Western Europe whose sole purpose was the provision of long-term finance for the promotion of industrialization and entrepreneurship. [i]

Microfinance is the provision of a broad range of financial services to low-income households and microenterprises. The range of financial services usually includes "voluntary" savings and loans. Other products might also include insurance, leasing, and money transfers. The term microfinance encourages exploration of the entire range of financial needs and requirements of poor people.

PERERA, Phillips (1968): During the 1960s development banks came into fashion as vehicles for the disbursement of development loans. PERERA cites two inventories that reveal an increase from 125 development banks in the less-developed countries in 1964 to more than 300 institutions in 1968. [ii]

Microfinance is an enabling, empowering, and bottoms-up tool to poverty alleviation that has provided considerable economic and non-economic externalities to low-income households in developing countries. In the long run, access to adequate and appropriate financial resources is critical in solving societal problems such as illiteracy, poverty, lack of skill, inaccessible markets etc. and the real issues that lie behind these issues: lack of political will and leadership, lack of transparency, high graft and corruption, lopsided developmental policies etc.

BOUMAN & Otto HOSPES stated that, Development banks, after their mushrooming in the 1960s now the main channel for development finance, shifted their targeted and subsidized credit programs from industrial and infrastructure development towards small farmers and businesses and similar target groups. Thus, they became an integral part of the Green Revolution by providing capital for the mechanized agricultural production, high-yield seeds, and chemical fertilizer to individual small farmers and agricultural cooperatives at low interest.[iii]

Microfinance is indeed an essential ingredient in the development process - but not the only ingredient. Today use of the expression micro financing has “said to be” its 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. Microfinance is the number one buzz word in the development sphere nowadays.

In 1980s, the arguments of Ohio State University: For an end of subsidized development and more liberalization of local financial markets fell on fertile ground. Public development banks not only stood in the way of financial stabilization because they constantly lost tax money, but also contradicted the ruling Washington Consensus which disapproved of state intervention in the market in general. So, international and national funding for state-owned development banks was drastically reduced and they were consequentially dissolved, restructured or privatized. [iv]

The basic idea of microfinance is to make financial services available for those excluded from the conventional banking system. By charging market price interest rates on the loans granted the business is meant to become sustainable and independent of fluctuations in cash flow from donor funding. During the last decade microfinance has become the latest trend in the development discourse, celebrated for empowering poor women to work their way out of poverty. Self-Employed Women’s Associations (SEWA), was alongside Grameen Bank one of the pioneers in the microfinance sector and has developed an integrated approach based on the life cycle needs of the members that is assumed to help them break the vicious circle of poverty. A type of banking service that is provided to unemployed or low-income individuals or groups who would otherwise have no other means of gaining financial services. Ultimately, the goal of microfinance is to give low income people an opportunity to become self-sufficient by providing a means of saving money, borrowing money and insurance.

The decline of state-owned development banks in the early 1980s coincides with the rise of microfinance as we know it today. In 2008, the Microfinance Information Exchange (MIX) comprised about 1,400 MFIs that served almost 100 million customers in all parts of the developing world. With thousands of smaller NGOs and self-help groups that do not have the level of sophistication to report to MIX

It is important to distinguish this term from the term microcredit. Microcredit refers to the provision of credit services to low-income clients, usually in the form of small loans for the purpose of microenterprise and income-generating activities. A focus on “credit only” in financial development interventions ignores the reality that creating access to credit will not necessarily meet the financial needs of the poorest or alleviate poverty. This strategy may further marginalize those poor people who are unable or unwilling to take up loans and risk increased debt. Savings and credit groups that have operated for centuries include the "susus" of Ghana, "chit funds" in India, "tandas" in Mexico, "arisan" in Indonesia, "cheetu" in Sri Lanka, "tontines" in West Africa, and "pasanaku" in Bolivia, as well as numerous savings clubs and burial societies found all over the world. In the early 1970s, few experimental programs had started in Bangladesh, Brazil and some other countries. The poor people had been given some small loans to invest in micro-business. This kind of microcredit was given on the basis of solidarity group lending, that is, each and every member of that group guaranteed the repayment of the loan of all the members. As Kofi Annan once put it, microfinance not only recognizes the needs of the poor, it also empowers them and taps into their remarkable reservoir of energy and knowledge. In short, microfinance has tremendous potential; its time is now and is here to stay.

2. Definition of microfinance:

As the name suggests, microfinance is the provision of financial services (loans, savings, insurance) to people on a small scale, such as businesses with low or moderate incomes, but you can read more meticulous definitions here and here. Loans of micro value are one of the better-known means of helping small business owners in developing countries move out of poverty. The definition for according to The Asian Development Bank (ADB) is any financial service targeted toward the poor, such as:

- Deposits
- finance schemes or loans
- payment services
- money transfers
- insurance to poor and low-income households and their micro-enterprises

3. Comparison of development banking and microfinance

In development banking, three major theoretical features can be identified:

- Credit targeted to specific sectors
- Subsidized credit
- Below-market interest rates

In microfinance major theoretical features can be identified:

- Target strata, not sectors
- Partially subsidized credit
- Market-based interest rates

Microfinance providers can be broadly grouped as follows:

- Formal Microfinance Institutions – rural/microfinance/village banks, commercial banks, telecom firms, and cooperatives offering loans to lower-income group individuals
- Semi-formal Microfinance Institutions – nongovernmental organizations providing micro-sized loans
- Informal Microfinance Sources – money lenders and shopkeepers who often loan money on a daily basis and charge exorbitant interest rates.

4. Effects of microfinance:

- Microcredit helps to increase household income.
- Through microfinance, people can diversify their income sources and enhance growth of enterprises.
- It provides access to financial services to poor people which enables them to create their assets.
- Micro financial services enable poor people to minimize the risks and take greater advantage of upcoming opportunities.
- In India, through micro finance, the government has been able to create job opportunities in the rural areas.
- For women, microfinance offers opportunities for self-employment.
- Introduction of microfinance leads to an increase in the enterprise revenue.

5. Hurdles in microfinance :

Despite good intentions, microfinance still has several hurdles:

- It is perceived as a risky lending source to the poor and the loan may be misused easily
- There is lack of awareness about sources of funds for microfinance providers to pass on to the poor
- Many people are not able to offer marketable collateral for loans to MFIs
- There exists poor distribution system of MFIs to spread out loan facilities into rural areas
- It is difficult to measure social performance of MFIs
- Some microfinance providers combine charity with business
- High interest rates are charged on microfinance
- There are technology-related hurdles, such as high costs involved in small loan transactions for microfinance providers
- There exists poor institutional viability of microfinance ventures
- There is a lack of customized solutions/ microfinance models for the poor
- Lack of training for MFIs makes it difficult for implementing their Microfinance schemes
- There is lack of awareness about microfinance investment opportunities
- It is difficult to achieve dual mission of MFIs i.e. to be financially sustainable as well as development oriented

6. Group lending can be the solution:

For optimizing utility of credit and welfare of the economy, the researcher suggests that individual and group lending can be used together in the market to perform better. Group lending mitigates information problems, increases repayment rates and is therefore is a key factor in microfinance.

7. CONCLUSIONS:

Microfinance as an instrument of lending promises to be an inclusive mechanism. However, Microfinance is yet to prove its worth as an instrument that would reduce poverty and bring changes in the rural socio-economic structure. In some countries, it is generating positive results. The study of the impact of microfinance means how the micro finance services impact the lives of the rural and as well as urban poor people. That is, whether or not micro finance enhances the process of income growth, poverty reduction, asset building etc. The admittance of commercial banks and other formal financial institutions into microfinance may enhance the competition for the ongoing microfinance institutions. The government's strong resolve to support microfinance services through procedural flexibility and incentives is needed.

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