

An analysis of microfinance and poverty economics essay



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“ This is not charity. This is business: business with a social objective, which is to help people get out of poverty” – Dr Muhammad Yunus (www.environmentalquoteshomepage.com)

Jonathan Morduch, Chairman of UN Expert Group on Poverty Statistics quoted that “ Microfinance stands as one of the most promising and cost-effective tools in the fight against global poverty.” Economic growth of the economically, socially and geographically disadvantaged segments of the population of any country requires access to financial services. The disparity between the rich and the poor continues to grow wider and therefore microfinance institutions were introduced to help the less unfortunate people who did not have enough money for survival. It is usually in the narrow sense called ‘ micro’ because the microfinance companies deal with small amounts of loans for e. g. small savings and small loans. These loans are given to unsalaried borrowers, taking very little or no collateral at all. In a broader sense, microfinance refers to a movement where there is an easy access to financial services for the low income clients to build assets, stabilize consumption and protection against future risks.

Microfinance clients are usually people who fall under the poverty line and do not have any access to any financial institution for them to borrow from. The poor people usually save in the informal ways for e. g. They invest their assets in gold, domestic animals, land etc however informal saving has serious limitations. The poor are more likely to lose out on money through mismanagement or fraud. Banks do not entertain the poor people because they do not have collateral or enough money to open a savings account therefore it is not feasible for a poor person to access the banks.

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There are several microfinance institutions in the world mainly in the developing countries. The leading countries are Bangladesh, India, Colombia, Mexico, and Morocco. Micro financing has its roots from the 1870's in Ireland nevertheless today the history of microfinancing hails from the Grameen Bank in Bangladesh. Professor Mohammed Yunus along with his graduate students of Chittagong University designed an experimental credit programme to serve the poor facing banking problems. Through the help of rural banks they were able to disburse and recover loans. Although this project was a huge success the banks refused to take over it considering it to be too risky and expensive. Ultimately through support of benefactors, the Grameen Bank (Grameen meaning 'rural' or 'village') was founded in 1983 and now provides loans to more than 4 million borrowers. The underlying objectives of the Grameen Bank was to eliminate the exploitation by landlords, perk up the standard of living particularly for women and to reverse the old age vicious cycle of 'low income meant low savings resulting in low investment. They wanted to inject credit into the cycle thereby increasing the investment size. Microfinance was not considered to "hand out" rather they introduced improved repayment rates. They focused on the ceiling in the interest rate and credit subsidies that retarded the expansion of the financial services. The poor people were shown that the repayment rates were better than the formal financial services were offering to them. The two features which helped Microfinance institutions to attain sustainability and reach large numbers of clients were the "high repayment" and the "cost-recovery interest rates". Additionally to a bank account, there are other financial services like insurance, credit savings and other payment facilities. "Financial inclusion" represents the easy access of financial

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services to the poor and low-income groups. One of the crucial functions of the financial system is to allocate the resources effectively for increase in production, increasing opportunities and reducing poverty. (microfinance). Over 40 % of the Indian population has income earning but no savings since they are excluded from the financial system.

It has been almost 25 years since the birth of microfinance since its introduction by the Grameen bank. The UN Year of Microcredit in 2005 showed a turning point for Microfinance as the private sector began to take a more stern attention to what has been well thought-out as the field of NGOs. Even with all this enthusiasm about poverty alleviation and contribution of financial services the Consultative Group to Assist the Poorest (CGAP) ' estimates that about only 5% reaches the poor clients' (repository). India is a home growing and innovative sector to microfinance. India is likely to make microfinance its abode as it has a huge population of the world's poor. One of the largest microfinance institutions is Self Employed Women's Association (SEWA) in India. It is the largest organization based in Asia to members who are poor, self-employed women workers earning less than US\$1 per day. SEWA corresponds to a union of three movements - " the labor movement, cooperative movement and the women's movement" SEWA builds the capacity of poor illiterate women to manage their own micro-enterprises. The staff is recruited and promoted from its own member groups, thus it has been able to develop managers" who although illiterate, become professionals through practical experience." " SEWA's combined approach to poverty alleviation comprises: (a) organizing for collective strength; (b) capital formation through access to financial services; (c)

capacity building and (d) social security; to enhance women's productivity and to ensure that sudden crises are not a drain on their fragile economies.

“ In 1972, SEWA was registered as a trade union that began in Gujarat in India”. Though it started in the urban region of Ahmadabad yet their main focus group was the organization of poor yet self- employed women workers especially in the rural part of the region. SEWA has also spread its branches out in the national and international level. These women are the ones who earn their daily income through various small scale businesses or by working in agricultural lands and making handmade materials including hawkers, home-based workers and manual laborers. They do not acquire any regular salary like the people employed in the urban organized sector. They are the “ unprotected labour force of our country. Comprising of 93% of the labour force, women constitute about 94% from the unorganized sector.” (www.sewa.org). This microfinance institution is registered under the “ Trade Union's Act of 1926 and is open for membership to all women all over India. In order to start organizing the finances, the organization has introduced a membership fee of Rs 5 annually.

An election is held for the representation of the organization. The union consists of a two tier level representation elected by the members. One representative member governs 100 members under one's group. The union is governed by a two-tier level of elected representation.

With globalization, liberalization and other economic changes, there are both new opportunities as well as threats to some traditional areas of employment. “ SEWA's first main goal is full employment ensuring work

security, income security, and food security. The second is social security and self-reliance". At SEWA the main objective is meant to attain ' full employment and self reliance' through the policy of hard work and growth. By ' full employment' means employment whereby workers obtain security in matters of basic amenities such as work and social needs including food, health, shelter etc. There is a need for great effort against many obstacles, limitations and restrictions faced by them or enforced on them by society and the economy, These development activities done by microfinance institutions reinforce women's bargaining power and offer them new options. SEWA is not only an organization but also a movement that took place to bring up the downtrodden and the poor. In India, this largely self-employed segment forms roughly 90% of the whole economy. A collection of women consequently founded the SEWA bank as a co-operative to empower deprived self-employed women by making available for them financial services and access to credit to lessen their reliance on manipulative money-lenders ([www. gdrc. com](http://www.gdrc.com)).

About one billion people globally live in households below the poverty line earning about less than a dollar a day. Policy makers and NGO's who want to change the poor people's lives face an uphill battle every day. There have been reports where major organizations like World Development Bank and other associations have extended a helping hand by granting the developing countries with financial aid however due to the bureaucratic behavior and corruption this aid has not reached the low level of the income strata. The grants given by the governments make matters worse by increasing the dependency of the poor and acts as a disincentive to the poor as they

choose not to move ahead and develop. The microfinance institutions around the world continue to help the downtrodden by increasing their capacity to invest and improve their living standards. " As James Wolfensohn, the president of the World Bank has been quick to point out that helping 100 million households means that as many as 500-600 million poor people could benefit." (Jstor) . Poverty alleviation is one of the most sought out strategies that every country encloses in its priority list however since decades this has failed due to loans not being repaid, cost of subsidies increasing tremendously and credit reaching the politically powerful rather than the underserved.

The purpose of Microfinance institutions in India is to extend financial help to its client and to maintain financial sustainability. The microfinance chooses the groups for their financial transactions. These groups may be Self-Help groups. The group takes responsibility for the financial borrowings taken by the members. Even though a few institutions may require capital, the loan repayment method has become quite popular amongst microfinance organizations. Although these high repayment rates may seldom translate into profits. The institutions try and involve the governments as well and keep an eye on the incentives that chase off efficiency in people's performance. Microfinance depends on pouring of finances from donors however the donors are against the continuous dependence on subsidies. The donors believe that subsidies should only be provided at the start of a project to cover up starting costs. (Murdoch)

Self employed women workers and are quite active in the economic sense and therefore add to the expansion of the economy. They are primarily
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engaged in production, trade and the service sector as a whole. However, in spite of their uphill struggle and their input to the country's overall gross domestic product, they have are not provided with any financial services, which could help them upgrade in their own labor and output. (www. sewa. org) These self-employed women cope with two major financial problems: shortage of working capital, and Non-ownership of assets'. The banking sector was not responsive to the needs of these self- employed women and the money lenders were very exploitive in nature. " Thus, sequentially to tackle this problem and liberate themselves from the cruel phase of eternal debt, the SEWA members came together with their own solution, in a meeting in December 1973: " a bank of their own", where they could be privileged enough to be accepted and not to be made feel inferior by the exploitative money lenders and ' indeed 4, 000 women contributed share capital of Rs. 10/- each towards the creation of the Mahila SEWA Co-operative Bank' (www. sewabank. org). In the year 1974 in May, " the SEWA Bank was registered as a co-operative bank under the dual control of The Reserve Bank of India and The State Government. Since then it has been providing banking services to poor, illiterate self-employed women and has become a viable financial venture". (www. sewabank. org)

SEWA started its own bank to provide women with access to microloans. ' Swashrayi Mahila Sewa Sahakari Bank is SEWA members' largest cooperative, unheard of in India. The bank is in possession of the self-employed women as share holders; policies are devised by their own particular Board of elected women workers. The Bank is managed professionally by qualified managers liable to the Board. In 1974, SEWA Bank

was established with 4000 members each contributing shares capital of Rs . 10 each. Currently there are 93, 000 active depositors. SEWA Bank in the year 1999, celebrated 25 years of granting financial services to the poor, self-employed women. Constantly in debt, our members initially brought up the matter of their need for credit so as to free themselves from the control of money-lenders and traders, to augment their businesses, build up assets in their own name, for children's education, for the several crises including illness that they might occur and for many other purposes'. (www. sewa. org).

SEWA has been successfully lending money to women for various needs such as running a household or for their children's education or weddings etc. Since women are achieving the two goals of the SEWA association they are ought to receive the support services such as health care, child care, insurance claim, legal help, communication services and capacity building. These services could be used for self-employment. Also women are ready to pay for these services which made the services financially viable. They don't have to depend on grants and subsidies for the use of these services. Some supportive services such as child and health care including savings and credit have formed their own co-operatives and have also gained operational self- sufficiency. Access to finance is a major problem for economically deprived women and in particular for poor self-employed women in countries that are developing such as hawkers, street vendors, home-makers, manual laborers and service contributors. As they do not save, disasters and compulsions time and again compel women to scrounge heavily. However, they do not possess the necessary experience and confidence to acquire

credit from a financial institution in the recognized sector and the formal sector does not lend to the self employed women easily, therefore, one depends heavily on informal money-lenders, who charge exorbitant interest rates: This is usually the start of a negative skew of increasing indebtedness. SEWA Bank as a cooperative bank with the precise aim to provide credit to self-employed women with the vision to empower them and reduce their dependency on loan sharks. Initially, the SEWA Bank focused on drawing deposits from self-employed women and supplied it as an intermediary to facilitate depositors to procure loans from nationalized banks which are obliged to lend to the poor. In 1976, the SEWA Bank began to offer loans to its depositors from its own funds and steadily withdrew from the credit agreement with the nationalized banks.

The bank employs a woman who saves as a organizer between other women to encourage them to save in the bank as well. The organizer usually visits the women easy accessibility to the depositing of the savings by them. If a loan is required by a woman requires a loan, a member has to accompany her in order for that loan to be sanctioned. The bank scrutinizes the application process, carefully reviewing the applicant's ability to generate income, standard of living, soundness of working conditions and capability to repay. Majority of the loans are unsecured; the process of approval takes about one week. If collateral is offered then the approval day is shortened and the loan could be granted the same day. " Once the loan has been approved, the borrower is obligated to buy 5 % of the loan amount in bank shares and to open a savings account if she does not have one yet. Women

are encouraged to register their savings account and their assets (such as working tools, house or land) in their own name” (www. Gdrc. org).

SEWA bank has also introduced various other schemes such as “ Crisis Mitigation Scheme”, House Financing Scheme, Women Farmers Credit Scheme, and ‘ Sunrise Scheme’ for developing women businesses. Self-employed women need loans for an ample range of reasons; to obtain assets, raw materials, finished goods for resale, and trade-in old debts, improve their homes, buy transportation means or install amenities in their house, for instance electric and water connections. The bank gives long-term loans, i. e. 3-5 years, of no more than Rs. 50, 000 which is an unsecured loan at the rate of 14. 5%- 17% and the method used for this lending is the Diminishing Balance Method (This method is also applies a fixed percentage but it applies to the diminishing value of the asset and not to the initial value of the asset) (www . howto. co. uk). Each loan is sanctioned with a pre check of the house visit by a SEWA bank field worker. SEWA Bank has been supplying a wide variety of loan products to meet the productive credit requirement of its clients. SEWA Bank necessitate a woman save regularly for at least one year, before she is eligible to apply for a loan. If there is an absence of traditional collateral, like jewellery or domestic animals a regular savings habit is considered a necessary form of security, in SEWA Bank’s experience of banking with the poor for over 25 years. SEWA Bank lays great emphasis on savings. All the self-employed women required a safe place to save their earnings and building up a credit loan from member savings was a very cost-effective method. SEWA bank introduced ‘ India’s first Micro-Pension Scheme’. In April of 2006, SEWA members were

approved to bond with a SEBI approved pension plan that presents no assured returns but permits up to 40 % collection to be invested in the Indian stock market. A number of countries were providing general insurance in India. Life insurance was nationalized and the Life Insurance Corporation of India (LIC) became the only authorized insurance life insurer.

“ In 1992 SEWA started an integrated insurance programme for its members. It was started with the objective of providing a support to poor women in times of calamities. It is a collaborative effort of SEWA, SEWA Bank and the nationalized insurance companies. Currently, SEWA has its own insurance unit called VimoSEWA which insures women for life, health, assets, widowhood and accidents in Gujarat. Starting with 7, 000 members, it has now reached more than 70, 000 women in 11 districts of Gujarat state. The total number of insured's, women and men, is 90, 000” (www. sewabank.org)

Why do MFIs target women?

Microfinance is a ' women's movement' but there is a logic that MFIs tend to target women for the practical reason that they are willing to attend group meetings and to comply with savings and loan terms. They may also believe that women are more conscientious in using finance for the benefit of the family. Men, by comparison, prefer larger, individual transactions. Lending to women guarantees the microfinance that the money is well spent on education, health, housing, and nutrition, making sure that they maximum money is directed toward the benefit of the family and the community.

Financial independence and security gains a woman respect in the society and she is looked up to by other people. Decisions to make own choices

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could help the family from the clutches of poverty and social exclusion. “ The SEWA Bank has ‘ broken the vicious circle of indebtedness and dependence on middlemen and traders’, and this has increased the bargaining power of the women. Many of them have upgraded their skills, developed more business and increased their income.” (www. “ The World Bank Global Learning Conference in Shanghai in 2004 confirmed the impact of microfinance: “ Studies have showed that microcredit programs positively affect a woman’s decision-making role, her marital stability, and her control over resources and mobility. The analysis establishes that a woman’s contributing to her household’s income is a significant factor towards her empowerment” (tars)

The world has failed to understand is that the poor are not victims of a system that failed or passive receivers of domestic and foreign aid. The poor have had the willpower and organization to take action to the problems that affect their lives. As long as affluent nations give out free donations and “ help” to poor countries, the people themselves will never be empowered to break free from oppressive conditions of poverty. The poor, if given the opportunity for economic advancement, can and will prove to the world that they are capable and responsible citizens.

There are five major criticisms of microfinance: it is does not reach the chronically poor of the population, it is not financially sustainable for institutions, it is potentially harmful to women (domestic abuse may result from husbands jealous of their wives’ new financial power), it can create a large debt for the poor, and it is not universal in application. Though these criticisms are valid, there is ample evidence to show that the benefits of <https://assignbuster.com/an-analysis-of-microfinance-and-poverty-economics-essay/>

microfinance outweigh the costs. There are various examples to show that microfinance can lead to an income increase, better opportunities for growth of the family as a whole, better education and employment. Microfinance also leads to empowerment of women especially in developing countries and alleviation of poverty. Microfinance could be the answer to secure success for the Millennium goals.