

MICROFINANCING AND ALLEVIATION OF POVERTY: A SOLUTION TO PRESSING ISSUES OF EMERGING MARKET ECONOMIES

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ABSTRACT

This paper has looked into the benefits of microfinancing as well as cooperatives, with special reference to India, and has concluded that by and large such institutions have filled the gap that has been left vacant by macro- finance institutions. They have been a great asset to society and especially to women. The sense of being master of your own business has enabled the upliftment of several citizens above the poverty line. Though the success of microfinancing was first seen in Bangladesh, it has been copied in many emerging market economies with success. There have been negative issues like indebtedness leading to suicide which have arisen in the process. Addressing them would help in strengthening this avenue of empowering both men and women.

Research Question: The paper will attempt an analysis of the use of microfinancing in the alleviation of poverty. This is a pressing issue for most emerging market economies including India. Two case studies would be attempted to evaluate the role of these institutions.

1. Definitions

Microfinance means that the economy is providing finance or money in small quantities to people who are poor (low income) and do not have the required collateral to obtain loans from banks.

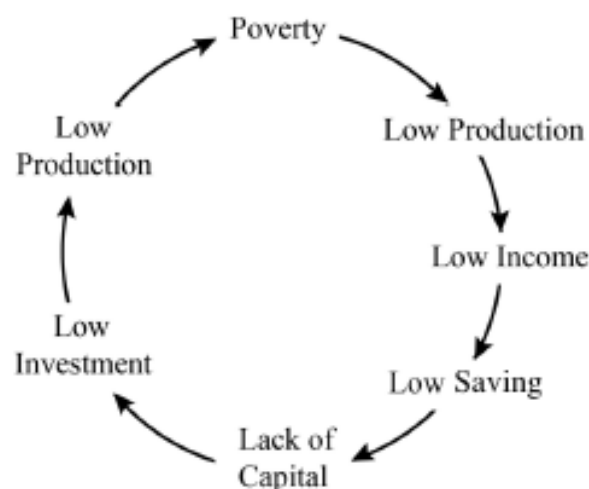
Most banks in an economy and especially for emerging market economies require a lot of collateral and paperwork before a loan is sanctioned. As an emerging economy consists of a large number of citizens who exist at the subsistence level it becomes difficult for them to obtain and service a loan. The subsistence level means that the people earn just enough for them to exist or subsist. They are not in a position to generate savings and thus do not have money or investments for their small ventures. If they cannot generate savings then it becomes difficult for them to invest, resulting in them living in perennial poverty.

For an economy to uplift this section of society, various other alternatives would have to be explored. In emerging market economies like India and Bangladesh, the number of people who are living at this level is close to 50% of the population. Thus, it becomes a very important issue for the country in question to find a solution. It is in this context that the paper attempts a system of microfinancing institutions.

1.1 Microfinance

Microfinancing is a system by which micro-loans are provided along with basic financial and business education. All this with the aim of empowering the poor. It is a banking service which enables unemployed and low-income individuals to access funds so that they are in a position to increase their incomes. The type of finance that one partakes in from microfinancing institutions is different from those that are disbursed by intermediaries like moneylenders, who operate in areas where there is inadequate finance. Rural areas of emerging market economies do not have adequate financial institutions. These intermediaries are financiers who are in the business of money lending and not only take collateral in the form of the farmer's land but also charge very high rates of interest which can range from 2-4% per month. If no collateral is given to them, the interest rate could be even higher. Once the farmer or any individual in the rural area gets into their clutches it is difficult for them to get out of the system. The final result being further poverty which may extend to future generations. To get out of this vicious circle of lending and poverty, one of the systems that have been developed and widely acclaimed as successful is microfinance.

Figure 1: Poverty Cycle



Source: google images

1.2 Intermediate finance in the agricultural sector in India

Agricultural loans in India are required for purchasing land, seeds, boring a well, farm machinery, etc. Money is also required for unforeseen circumstances like the birth of a child, marriage and death. Besides the above, money could be needed for storage purposes, logistics, etc. As approximately 84% of the farmers in India have less than two hectares of land and amongst them, more than 60% have one hectare or less, the lack of money becomes a serious issue for this section of marginalised poor farmers. Most of them live in abject poverty. For them to move above the poverty line becomes imperative. They have great aspirations to improve the well-being of their family. The only way this can be done is via education. They find various means to enhance their income including jobs like casual labourers.

An additional way could be to take the support of microfinancing as an efficient alternative to borrowing at high rates of interest. The most famous case of successful microfinancing has been in Bangladesh. In the course of the paper, an attempt would be made to look at two case studies. The first being the Grameen Bank, Bangladesh and the Amul corporative in India. Both of them are success stories and as far as possible should be emulated in other fields.

2. Origin of Microfinancing

The first known institution of microfinancing is the Grameen Bank which was developed in Bangladesh by Dr Muhammad Yunus who was subsequently awarded the Nobel peace prize in 2006 for their contribution “to create economic and social development from below”.

2.1 Grameen Bank, Bangladesh

The Grameen Bank was started in the 1970s by its founder Muhammad Yunus.

Figure 2: Grameen Bank



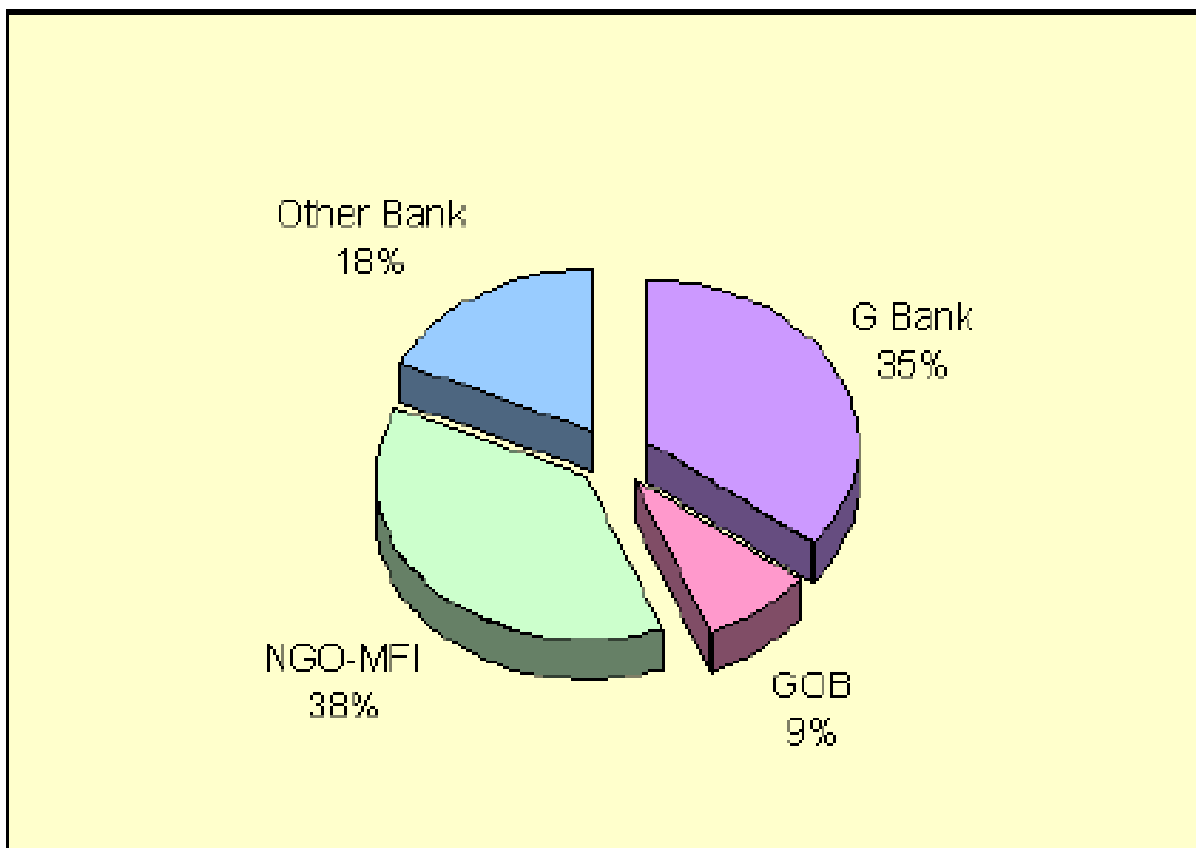
Source: Google Images

The world has a lot to thank for the development of the Grameen Bank as a microfinance

institution. It has set the foundation for the structure and formal approach to microfinance and has influenced generations of such institutions across the world. Mohamad Yunus realised the fact that the basket weavers in Bangladesh relied on exploitative money lenders to buy their raw materials. As an experiment, he decided to give \$27 so that they could produce an item and sell it for a profit. When he saw the positive impact it had, he decided to extend this model to other districts in the country. The main aim of this model was joint liability as well as offering collateral-free loans. As Most of the weavers/workers were women, he found that:

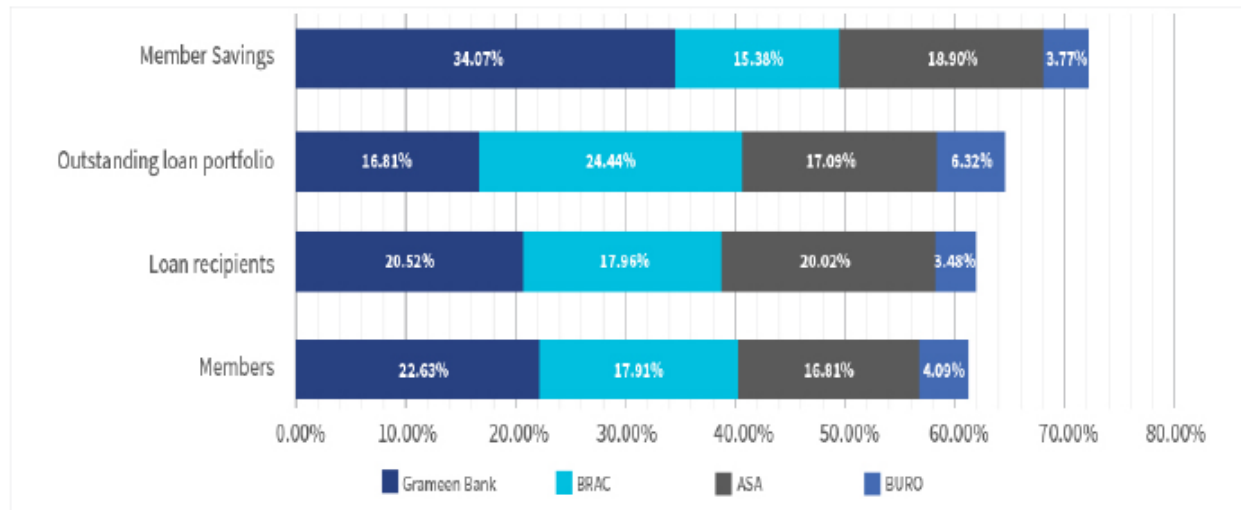
- They generally repaid their loans on time
- They used the money for productive purposes
- Expenditures were incurred to improve the quality of life for their families

Figure 3: Institution-wise Cumulative Loan Disbursement in 2002 in Bangladesh



Source: <https://www.bb.org.bd/saarcfinance/seminar/cpbdesb.php>.

Figure 4: Market share of performance metrics of the market leaders in the Bangladesh MFI industry as of 2019



Source: <https://www.microsave.net/2021/08/05/bangladesh-the-basket-case-that-taught-microfinance-to-the-world/>

Both the figures above indicate the importance of Grameen Bank in Bangladesh in the dispersal of microcredit to the poor. This empowered women as well as brought to the forefront their role as efficient household budget managers. It is after this that social entrepreneurs like Sir Fazle Hassan Abeb initiated The Bangladesh Rural Advancement Committee (BRAC). This was instituted to help the returning refugees build homes and fishing ports and to help mothers prepare and administer Oral Rehydration Solution (ORS) to counter dehydration amongst children. BRAC consisted of four pillars:

- Institution building
- Functional education and training
- Micro Credit
- Income and employment generation

Here too microcredit was the main institution to address poverty.

Grameen Bank and BRAC worked on the concept of compulsory saving. This means that members could not access their share value until they left the organization. However, this was

counterproductive and led to protests and mass defaults by the Grameen Bank's clients in the mid-1990s who demanded their shares of savings. The Grameen Bank was the most popular institution leading to rapid growth in its membership, as it offered a way for borrowers to navigate the largely inflexible annual loan interest and principal repayment with weekly repayment. The biggest impact of the Grameen Bank was to convince the financial sector that:

- The poor are bankable
- They utilize their loan and repay on time
- They perform better in contrast to wealth borrowers

Professor Yunus created a Grameen Trust in 1989 as a private, not-for-profit, non- government organisation (NGO). The bank's origin in the early 70s was to lend to women in ordinary Bangladesh villages. 30 years later, Grameen Bank has more than 3.2 million borrowers of which 95% are women. The origin of the bank was to alleviate poverty in one of the poorest countries of the world. At that time, Bangladesh had a literacy rate of only 38% for those over 15 years of age (CIA, World factbook 2003, S.V. " Bangladesh," <http://www.cia.gov/cia/publication/factbook/>). It was experiencing drought and famine that killed 1.5 million people(Macfarlane 2002). Professor Yunus in his interviews has indicated that his vision was a chance encounter in Jobra with Sufia Begam, a 21-year-old woman who stated that she wanted to support herself and she had borrowed a paltry sum and was being charged 10% per day. Her occupation was making bamboo stools. As she had to repay the money lenders, she was selling the stools at below her cost resulting in her being a bonded labourer to the money lender. Professor Yunus found 42 such women who were in the same poverty trap. He lent them the money from his own funds and to his pleasant surprise found that all of them returned the money. It is from this effort that an idea emerged of extension of financial and business services to that section of society who were extremely poor to qualify for traditional bank loans. This model has been a game-changer and has led to:

- Creation of wealth
- Generating positive externalities
- Better education
- Improved health

After this successful experiment, Yunus took his proposal to traditional banks and suggested that traditional banks should make uncollateralised loans to society. But, the concerns that came up

were that the loans were very small and they would not be able to cover administrative costs. Besides this, the female borrowers would just hand over the funds to their husbands and they would further sink into indebtedness.

When professor Yunus was not able to solve the issue with traditional banks, he started an institution of his own called Grameen Bank. The word ‘Grameen’ means village in Bengali. What he wanted to portray by this name was that capital is a friend of the poor and this is the only means for them to move out of poverty. By being a part of this venture, they would be in a position to escape poverty which had not been achieved earlier due to wasteful, corrupt, and incompetent government as well as international aid organisations. According to him, this bank would address all aspects of rural life from manufacturing to retail even door-to-door sales. The bank would not require collateral. And it would prove what Righter later referred to as “the bankability of the unbankable”. It was in 1983 that Grameen was incorporated as a bank after the government had passed legislation allowing the bank to accept deposits.

Figure 3: Map of Bangladesh



Source: CIA, World factbook 2003

The commitment of the bank was to provide loans to the poorest of the poor without collateral and their primary aim was to alleviate poverty, and not to make profits. Women would enter the

system through a self-selected lending group which consisted of 5-10 members. These were then ranked according to their poverty levels. The ones who were the poorest were the ones who got the loans first. It was the level of poverty which determined disbursement. As the members were known to each other, the pressure to pay back the loan was immense, knowing that this would impact the reputation of the village. It was the combination of support and peer pressure which motivated its members to meet the terms of their loans.

This was the first level of the system. The second level was a centre manager. He/she used to visit the borrowers regularly and interact with them to try and solve their issues so that they could keep to their commitment. These managers played an important role in selecting borrowers, approving lending groups, and supervising income-generating projects.

A significant design of the bank was that instead of the poor coming to the bank, it was the Grameen bank which carried the services to their doorsteps. A group of five prospective borrowers were formed and out of them, only two received the loan. If they managed to pay the principal plus the interest within six weeks then other group members would be able to become eligible for a loan. Given these restrictions, there was tremendous group pressure on the members to keep their records clean. The only criterion was their performance. It was in the shareholders' interest to take loans and repay them on time. As they were shareholders, they all were eligible for dividends declared by the bank. This inspired all shareholders to work extra hard and support the momentum that was the mainstay of the Grameen Bank movement.

It is after this that other such movements developed in Bangladesh. Each subsequent one tried to plug any loopholes or criticisms that were faced by the original.

2.2 Amul Cooperative

Amul is an Indian dairy state government cooperative based at Anand in Gujrat. This was formed on the 14th of December, 1946. It is a three-tiered structure, with the Dairy cooperative societies at the village level which was under the umbrella of a milk union at the district level and it then came under a federation of member union at the state level.

The main system of working and victory of this cooperative was based on a system of unity. This company changed the entire milk procurement process and spurred the white revolution in India. It was founded by a few farmers whose aim was to stop exploitation by middlemen. In the process, it grew from being a minute firm to a huge brand *Amul – The Taste of India*. It started with anger against the unfair practices of the middlemen. Tribhuvandas Patel approached Sardar Vallabhbhai Patel to solve their issues. Sardar Vallabhbhai suggested that they should work for themselves and become self-sustaining entrepreneurs. The movement started with a few farmers producing 247 Litres of milk and by 2015 more than 3.6 million milk producers were producing

more than 14.85 million litres per day. The Amul Cooperative was created by Dr Verghese Kurien who is also known as the father of the white revolution in India. The ownership pattern of this cooperative is a state government cooperative. The owners are the Gujrat cooperative milk marketing federation, the ministry of cooperation, and the government of Gujrat. The Amul pattern follows an integrated cooperative structure that procures processes and markets produce. It is supported by professional management. Producers decide their own business policies, adopt marketing techniques, and receive services that they can individually neither afford nor manage. It has the longest-running advertising campaign where the USP are the current trending issues.

Everyone looks forward to the *Amul Girls* advertisement and billboards.

Figure 4: Amul cooperative advertisement



Source: Google Images

Amul is a cooperative and is a collection of people who are already involved in the business of providing milk to the market. The main aim of this cooperative was to get rid of middlemen and enhance their profits.

3. Does microfinancing alleviate poverty?

Microfinancing circumvented the collateral requirement and provided funds at cheaper interest rates for the poor to enhance their business. What is true is that in most cases of lending by the Grameen Bank, women had an occupation and the reason they could not expand was a lack of funds. This lacuna was plugged in by the growth of microfinance institutions.

It would alleviate poverty as the women would have funds for expansion. The downside of this has been that large access to cheap funds has led to over-borrowing which was greater than the capacity to repay resulting in a huge number of defaulters. This has been seen in Bangladesh as well as Brazil, and other countries that have adopted this type of system of financing.

4. Lessons learnt from Bangladesh

The original idea of Dr Mohammad Yunus was to alleviate poverty in Bangladesh by empowering women. This would lead to a greater opportunity for women as well as enhance their social stature in society. This would be achieved by increasing the amount of funds available to expand their small ventures. What has emerged is that there has been an increase in indebtedness due to the cheap availability of funds. Poverty, as defined by qualitative indicators that include adjectives like vulnerability, deprivation, and helplessness, has increased. Vulnerability is defined as the insecurity of households in the face of a changing environment.

Instead of just providing money or finance to help the poor pull themselves out of poverty what is essential is to provide them with the skills and the capability to move from an impoverished state to a level above the poverty line. Though the provision of finance is an important ingredient in the reduction of poverty, what is even more important is the sustained effort to be out of poverty. For them to be successful entrepreneurs what is more important is the skill and education that the borrowers have. Besides this, the social setup concerning the status of women in society also goes a long way in achieving success with the help of microfinance banks. If the male member of the family forces the woman who can partake in a loan, for his venture then the whole purpose of provision of money to a women entrepreneur fails.

Thus, it is important that these types of societal pressures should be avoided as far as possible. But again, living in a male-dominated society, it is extremely difficult to move away from such issues.

The main reason for increasing suicide has been excessive borrowing and the inability to repay the amount even if the rate of interest is nominal. Once an individual starts defaulting, on a loan, several agents start stalking and harassing the borrower leading them to take the extreme step of taking their lives.

5. Conclusion

The lessons that we learnt from Bangladesh Grameen Bank and other such micro-finance institutions which have been set up all over the world is that just giving finance at cheaper rates to women is not the only solution for empowering them. There must be a considerate effort in skilling them as well as changing the mindset of society towards women empowerment. This

requires efforts from all stakeholders starting with the government, private sector, public sector, and non-governmental organizations (NGOs). The Grameen Bank was a phenomenal endeavor in the upliftment of women, and it did succeed to a very large extent initially, but as the news of its success spread it developed flaws and people started finding loopholes in the system which led to several dissatisfied poor, at times leading them to commit suicide.

Thus, what is important is that besides finance, skilling, educating, and empowering women will be the key to reduction in poverty. Educating and empowering a woman means that the whole family would be able to move up the ladder. As she is the most important member who is wholly responsible for upliftment of the family. Women are a very important cog in the wheel in ensuring adequate care, health, and education to the whole family.

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