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Impact of Microfinance on Poverty Reduction: Critical Perspectives from Literature

Priyanka Murria*

Abstract

Microfinance has progressively become a panacea of the evils that inflict the contemporary economies especially the developing ones. There are studies on record that reflect that it helps in alleviating poverty by providing the poor funds through which they are in a position to commence their own business venture and hence it promotes the income-generating activities of the beneficiaries. This all results in promotion of earning of beneficiaries and helps in enhancing social capital in poor nations. The studies that emphasize the poverty alleviation are also gaining momentum in the literature and other scholarly works. As a result, more recently concerns have been raised about the real worth and impact of microfinance. In this direction, the present study is a stride that aims to ascertain the impact of microfinance on the much talked macroeconomic objective of poverty alleviation. For this purpose, the existing literature has been investigated both nationally and internationally. The extensive analysis of literature shows mixed results. Some reveal positive impact of microfinance on its beneficiaries while others clearly reject it. The studies that negate the positive role of microfinance emphasize that very poor are still outside the ambit of microfinance. Thus, based on critical perspectives from literature, it can be concluded that microfinance is one of the tools of poverty alleviation. However, it cannot alleviate the poverty from the grassroots level of society unless supplemented by other socio-economic initiatives where the government, NGOs and microfinance institutions would play a vital role.

Keywords: Beneficiaries, Income Generating Activities, Literature, Microfinance, Social Capital

Introduction

In the recent years, the economies round the world are striving hard to promote microfinance as one of the solutions to the problems that persist at grassroots level. One of such problems is the existence and the strong grip of poverty, which has shackled the lives of a significant portion of population in India and abroad. This population represents the poor, very poor and marginalized who have either no or little excess to credit. This is because of their inability to furnish collateral security, which is viewed negatively by formal financial institutions (Mcguire & Conroy, 2000). Thus, they do not have access to finance which acts as an impediment in their growth and thereby the growth of nation. The financing through microfinance seeks to provide a solution in this regard.

The provision of microfinance helps in engagement income generating activities (Nagayya, 2000) and thus has ability to give tangible results to the poor people, especially women (Balu, 2005). An engagement in activities leads to absorption of idle labour or workforce in activities that can provide them income (Vinayagamoorthy, 2007), which has a direct impact on poverty alleviation in countries including India (Barbora & Mahanta, 2001).

Objective of the Paper

The present paper is based on following objectives:

- To have conceptual understanding of concept of microfinance phenomena.
- To understand the positive and negative impact of microcredit on poverty reduction based on record literature.
- To draw inferences from impact analysis.

The Microfinance Phenomenon

According to Mcguire and Conroy (2000), microfinance refers to “the provision of financial services, primarily savings and credit, to poor households that do not have access to formal financial institutions”. It facilitates the development by making efforts in alleviation of poverty

* Associate Professor (Economics), Institute of Innovation in Technology and Management, Affiliated to Indraprastha University, New Delhi, India. Email: priyankamurria@gmail.com

Nagayya (2000) by providing financial services and ensuring social empowerment (Dadhich, 2001). Kalra et al. (2014) defined it as financial services for the poor that helps in addressing the issues posed by poverty and empowers low-income people. Recently, Yaidoo and Vishwanatha (2018) further elaborated the definition of microfinance and defined it as the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance. It was added that these services are provided to poor and low-income households on short-term basis.

Impact of Microfinance on Poverty Reduction

As far as the economic literature on the impact of microfinance through self-help approach is concerned, the literature shows mixed results. There are studies that reflect a positive impact of microfinance on its members, whereas there are studies on record that reflect negative results. These views have been represented under two sections viz. positive impact and negative impact. Section 1 represents the positive impact of microfinance on poverty alleviation. Section 2 represents the negative impact of microfinance as they opine that it is not an effective strategy for poverty alleviation and growth.

Section 1: Positive Impact of Microfinance on Poverty Alleviation

Nagayya (2000) observed that the credit supply through self-help groups is fast emerging as a promising tool for promoting income-generating activities and alleviation of poverty among poor with a focus on the women. Barbora and Mahanta (2001) asserted that microfinance through self-help groups (SHGs) has led to positive impact on microfinance clients of Grameen Bank of Bangladesh and has been recognized as one of the effective tools of poverty alleviation in countries including India. It was pointed that 80 per cent of the members of SHGs are from poor families.

On similar lines, Dadhich (2001) indicated that the group formation has positive impact as it leads to significant changes in the living standards of SHG members in terms of increase in income levels. Jha (2002) in a study conducted in Bangladesh found that the borrowing from the MFIs has had a positive impact on raising the income levels of self-help groups and has resulted in marginalization of moneylenders. Thus, rise in income level and reduction in borrowing from informal sources were highlighted because of financing from SHGs.

McKernan (2002) stated that microcredit programmes act as a means of poverty alleviation by providing credit to the poor for purchase of capital inputs and non-credit such vocational training, information in areas of health, civil responsibilities and rights, and information sharing and monitoring among members. Panda (2003) also reported that provision of microfinance had led to increase in income of beneficiaries, and rate of recovery had been good.

Balu (2005) reported a rise in income of members to Rs. 70000 per month from Rs. 2000 per month. Thus, the study found a positive impact on income generation. Wanchoo (2007) pointed out that microfinance aims at poverty alleviation by creation of social value, provision of capital for microenterprise, insurance and saving for risk mitigation and consumption smoothening.

Hossain and Knight (2008) observed that several governmental and non-governmental organisations (NGOs) in Bangladesh aim to decrease global poverty by adopting microfinance as a central element in their development programmes. The study concluded that Grameen Bank in Bangladesh has made a positive difference to the lives of the poor. It was also pointed out that MFIs in Bangladesh are targeting only the poorer segment of society.

Reji (2009) carried out a study on Nilambur block of the Malappuram Block of Kerala state. It was found that microfinance programme lead to increase in income of households. Ghildiyal (2009), Arabi (2009), and Abbasi (2009) found a positive and significant impact of microfinance programme on increase in income of household.

Chan et al. (2011) found that microloans lead to increase their household income. It was observed that 2.8% of the respondents experienced no change in income after joining group, 6.9% experienced a negative income, while approximately 26.4% increased their income by more than 300%.

Sulaiman (2014) conducted a study on Kudumbashree programmes in the state of Kerala and asserted that the entrepreneurship through Self-Help Groups has resulted in elevating the lives of rural poor. This is because of the fact that the funds generated through the income-generating activities of the members' rises the income of members and helps in capacity building for budding entrepreneurs. The study concluded a positive impact of membership of these SHGs on the income level of beneficiaries and thus defined it as an effective tool in eradication of poverty.

Singh (2016) opined that the provision of microcredit could help in mitigation of poverty. This can be done by the provision of credit along with provision of skill development and training. It was advocated that it would also help in stimulating the level of self-employment, which leads to generation of income and thus empowers the rural poor.

Bangoura et al. (2016) stated that providing access to loans gives to the poor the potential for income-generating activities and thus helps in poverty alleviation. Parajuli (2016) asserted that microfinance helps in poverty reduction by promoting business activities, creation of employment opportunities and fulfilment of food and capabilities for expenditure for children.

Islam et al. (2018) found that microcredit disbursement through major NGOs helped the beneficiaries by generating employment, improving level of living by better education, better health facilities. Mohd. (2018) asserted that microcredit is expected to play a significant role in poverty alleviation and is a useful tool of up-liftment in a developing country like India. A recent study by Sultaniya et al. (2019) highlighted the importance of microfinance and asserted that provision of funds to poor helps in poverty alleviation.

Yadav (2019) observed a positive role of microfinance in empowering rural women. The research work outlined that women empowerment and poverty eradication can be ensured by supplementation of economic empowerment with the psychological empowerment. In this direction, the paper also delineated certain psychosocial models that served as benchmark for uplifting the lives of poor. The paper ended with the conclusion that empowerment of rural women is an important tool in eradication of poverty.

Section 2: Negative Impact of Microfinance on Poverty Alleviation

Some studies, on the other hand, have pointed towards the darker side of microfinance. These studies have mentioned that the poor, in order to repay their loans, borrow from informal market at an interest much higher than market rates (Tiwari & Fahad, 1997). Mcguire and Conroy (2000) asserted that microfinance, of course, has helped in reducing poverty by increasing the income and consumption of poor households and thereby created positive social impacts on the members, but pointed out that very poor may still be outside the ambit of microfinance. It was argued that microfinance movement encourages poor to take loans that "they may not be able to pay" and adds that the impact of microfinance loan was small or negative for the "very poor". On the other hand, a positive impact was cited in case of households on or above the poverty line.

Ahmed (2000) found that a vast majority of "poorer of poor" are not yet covered by NGOs in Bangladesh. Field workers prefer not so poor and better-educated clients. Thus, it excludes most poor people and includes relatively well-off among the poor to realise good repayment rates. Satish (2001) stated that that most of the groups formed and financed are of poor women. It was also asserted that SHGs included very poor members but no conscious attempt was made by the promoters to include exclusively the poorest of poor. On the similar lines, Meher (2003) found a limited impact of microfinance through SHGs. It was claimed that microfinance fails to systematically reach the poorest and argued that microfinance can aggravate existing socioeconomic inequalities. Srivastava (2005) asserted that microfinance is reaching not the poorest of the poor, but only those near and above the poverty line.

Sooryamoorthy (2005) stated that microcredit benefits the less poor more than poorest of poor. It was pointed out that even in Bangladesh, large sections of hard core poor are left out. Shylendra (2006) asserted that very few poor clients have received benefit from microfinance operations. Shylendra (2008) also found a limited impact of SHGs on poverty alleviation. He observed that although SHGs had positively impacted women in terms of enhanced women participation as in the case of Bangladesh and India, very poor were still excluded from the benefit of SHGs.

Rathnam (2009) asserted that microcredit not an effective strategy for poverty alleviation and growth. It was pointed that small loans for short periods with tight repayment cycles limit its effectiveness. Arabi (2009) asserted that only 20% of the low-income group population has access to financial services. In line with these studies, Lokhande (2010) pointed that the women respondents under study were having uncertain, irregular and meagre income.

Idolaor and Imhanlahimi (2011) opined that microfinance programmes seek to reduce poverty by targeting financial services to the poor through provision of the products and services. However, it was highlighted that the impact of microfinance varies across different groups among the poor. It was asserted that majority of the respondents (605) earn less than 1 USD, 164 respondents earn just 1 USD and 81 respondents earn more than 1 USD.

Chanu (2013) reported a negative impact of microfinance on the lives of poor residing in rural areas. It was stated that microfinance is not a magic bullet for poverty reduction and rural development in India. Thus, the study negatively views the role of microfinance in mitigation of poverty. It was stated that it lags behind in catering to the needs of rural poor and does not help the poor on sustainable basis.

Bangoura et al. (2016) asserted that though microcredit is an important tool in the fight against poverty and inequality yet it couldn't be considered a sufficient solution in itself. An year later, Cull and Morduch (2017) opined that it is true that microfinance provides capital that would increase borrowers' earnings and ultimately eliminate poverty. It was also asserted that 'Microfinance is far from dead, but it needs fresh thinking'.

Banerjee and Jackson (2017) also found negative impact of microfinance. It was stated that microfinance led to increasing levels of indebtedness among already impoverished communities. It was pointed that microfinance even elevated the problems of beneficiaries on economic, social and environmental fronts. A study by Yaidoo and Vishwanatha (2018) further downturned the importance of microfinance as it asserted that microfinance indeed helps in poverty alleviation but to solve the problems of poor more emphasis should be laid on provision of jobs to poor and not on microfinance.

Inferences from Impact Analysis

Section 1: Positive Inferences

The studies that reflected the positive impact of microfinance on its beneficiaries reflected it as one of the tools of poverty alleviation (Barbora & Mahanta; 2001). This is because it leads to promotion of income-generating activities (Nagayya, 2000; Bangoura et al., 2016) which lead to rise in income of the members (Dadhich, 2001; Panda, 2003; Balu, 2005; Reji, 2009; Ghildiyal, 2009; Arabi, 2009; and Abbasi, 2009; Chan et al., 2011) and has resulted in marginalization of moneylenders (Jha, 2002). Some studies reflected that poverty is reduced by providing credit to the poor for purchase of capital inputs, and undertaking vocational training. In addition, it was asserted that microfinance facilitates provision of information in areas of health, civil responsibilities and rights and thus, ensures information sharing and monitoring among group members (McKernan, 2002).

A study by Wanchoo (2007) pointed out that microfinance aims at poverty alleviation by creation of social value, provision of capital for microenterprise (Parajuli, 2016), insurance and saving for risk mitigation and consumption smoothening. Hossain and Knight (2008) observed that Grameen Bank in Bangladesh has made a positive difference to the lives of the poor and is targeting only the poorer segment of society. Parajuli (2016) asserted that microfinance helps in poverty reduction by creation of employment opportunities (Islam et al., 2018) and fulfilment of food and capabilities for expenditure for children. Recently, Sultaniya et al. (2019) highlighted that provision of funds to poor helps in poverty alleviation (Mohd., 2018) and is a useful tool of up-liftment in a developing country like India.

Sulaiman (2014) conducted a study on Kudumbashree programmes in the state of Kerala and asserted that the entrepreneurship through Self-Help Groups has resulted in elevating the lives of rural poor. This is on account of the fact that the funds generated through the income generating activities of the members' rises the income of members and helps in capacity building for budding entrepreneurs. The study concluded a positive impact of membership of these SHGs on the income level of beneficiaries and thus defined it as an effective tool in eradication of poverty.

Singh (2016) opined that the provision of microcredit can help in mitigation of poverty. This can be done by provision of credit along with provision of skill development and training. It was advocated that it will also help in stimulating the level of self-employment which leads to generation of income and thus empowers the rural poor.

Yadav (2019) observed a positive role of microfinance in empowering rural women. The research work outlined that women empowerment and poverty eradication can be ensured by supplementation of economic empowerment with the psychological empowerment. In this direction, the paper also delineated certain psychosocial models that served as benchmark for uplifting the lives of poor. The paper ended with the conclusion that empowerment of rural women is an important tool in eradication of poverty.

Section 2: Negative Inferences

The studies have pointed that the poor in order to repay their loans borrow from informal market at an interest much higher than market rates (Tiwari & Fahad, 1997) and has added to indebtedness of clients (Banerjee & Jackson, 2017). In addition, 'very poor' (Mcguire & Conroy, 2000; Shylendra, 2008) or 'poorer of poor' (Ahmed, 2000) or 'poorest of poor' (Satish, 2001; Meher, 2003; Sooryamoorthy, 2005) may still be outside the ambit of microfinance and if they get loans they may not be able to pay them back (Mcguire & Conroy, 2000; Rathnam, 2009).

Ahmed (2000) pointed that field workers prefer not so poor and better educated clients. Thus, it excludes most poor people and includes relatively well off among the poor to realise good repayment rates. This results in promotion of socioeconomic inequalities (Meher, 2003). Microfinance programmes do not reach the destitute sections stated that a majority of microfinance clients belong to moderate poor, vulnerable non-poor households or those near and above the poverty line (Srivastava, 2005).

Lokhande (2010) and Idolaor and Imhanlahimi (2011) pointed that the women respondents under study were having uncertain, irregular and meagre income. Bangoura et al. (2016) asserted that microfinance cannot be considered a sufficient solution in itself. On the other side, Cull and Morduch (2017) opined that 'Microfinance is far from dead, but it needs fresh thinking'. On similar lines, Yaidoo and Vishwanatha (2018) asserted that more emphasis should be laid on provision of jobs to poor and not on microfinance.

Chanu (2013) reported a negative impact of microfinance on the lives of poor residing in rural areas. It was stated that microfinance is not a magic bullet for poverty reduction and rural development in India. Thus, the study negatively views the role of microfinance in mitigation of poverty. It was stated that it lags behind in catering to the needs of rural poor and does not help the poor on sustainable basis.

Conclusion

In Indian economic structure, the concept of microfinance has become one of the most discussed issues. It involves the provision of certain benefits to poor and marginalized groups. As a part of one of the discussed subject matters, it has attracted several research scholars or researchers, academicians, government departments, etc., to study its impact on economy. In this regard, the present study defines the impact of microfinance on its beneficiaries. The literature shows mixed results. Some define that it has become a significant tool of reducing poverty through enhancement of microenterprises, purchase of capital inputs, vocational training, creation of social value, provision of capital for insurance and saving for risk mitigation and consumption smoothening. Some studies highlighted that the poverty is also mitigated because of engagement in income generating activities as it results in raising the income of members and thus helps in capacity building for existing as well as budding entrepreneurs. It was suggested that provision of microfinance along with the skill development and training could help in elevating the lives of the poor.

However, some point towards darker side of it. They assert that the poor in order to repay their loans borrow from informal market at an interest much higher than market rates and has added to indebtedness of clients. In addition, 'very poor', 'poorer of poor' or 'poorest of poor' are still being outside the ambit of microfinance. The field workers prefer not so poor and better educated client to realise good repayment rates. This results in promotion of socioeconomic inequalities. Thus, majority of microfinance clients belong to moderate poor, vulnerable non-poor households or those near and above the poverty line. Some studies specify it as an insufficient solution, while others called it as 'far from dead, but it needs fresh thinking'. It was also asserted that provision of jobs not on microfinance should be emphasized. Thus, on the basis of critical perspectives from literature, it can be concluded that microfinance is one of the tools of poverty alleviation. However, it cannot alleviate the poverty from the grassroots level of society unless supplemented by other socio-economic initiatives where the government, NGOs and microfinance institutions would play a vital role.

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