Role of Micro Finance in Developing Indian Economy

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ABSTRACT

Microfinance refers to small savings, credit and insurance services extended to socially and economically disadvantaged segments of society. It is emerging as a powerful tool for poverty alleviation in India. This working paper tries to outline the prevailing condition of the Microfinance in India in the light of its emergence till now. One of the greatest challenges before the Indian sub- continent which accommodates more than one-third of the population is poverty. India, one of the BRIC nations with more than 1.2 billion population is seen by many developed countries as an emerging economy. India's economic growth has failed to make a significant improvement in its poverty figures with 400 million-more than the total in the poorest African Nations- still stuck in poverty. Government of India with its concern started various poverty alleviation programs but they have failed to deliver the objectives to the level which is desired. The reasons may be many such as failure to reach the target group, loopholes in the system, developing a robust mechanism to name a few. Many countries including India experimented with subsidized credit which only led to increase in the NPAs. The microfinance has come forward to fill up the gap. But the outreach is too small as compared to the requirement and potential. However there is some progress in this regard after active role played by NABARD and formation of SHGs groups. A number of NGOs and MFIs have also delved into the business. Some of them have also started in a big way and have started making profit by issuing IPOs (Initial public offers). But certain development in recent years has brought a fresh focus on the problem of regulation in field of microfinance. The paper delineates three distinct aspects of microfinance, first growth of microfinance in India and some other countries; secondly it discusses the role played by NABARD and other National Banks in growth of SHGs and Grameen Bank. Third, it deals with the role of government in framing legislation for protection of right of micro borrowers. The study also deals with the need for a regulatory body to regulate, develop and guide the numerous MFIs and NGOs who work in the field of microcredit. The paper discusses the factors related to practical as well as theoretical position associated with evolution of microfinance and its role in global scenario.

Keywords: Grameen Banks, Microfinance, NABARD, Poverty, SHGs.

I. INTRODUCTION

Microfinance is defined as, "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"(refer to bibliography). In other words it is provision of financial services such as savings, credit and insurance to individuals that fall below the poverty line. Microfinance therefore is also stated as creation of social value for these individuals by elevating their circumstances and helping them to envision the livelihood opportunities. Through the provision of capital for micro enterprise, savings for risk mitigation and insurance the purpose or the goal for the sustainability of rural developers is achieved. It is stated that private corporations, individual donors and government schemes are using range of microfinance methods. There are some banks like ICICI that provide access to help the rural developers by means of financial services. The Indian government adopts piloted national programs to contribute to the microfinance for the rural developments. NGO's on the other hand undertake fund raising activities and encourage donors to participate in microfinance as much as they can. The purpose of this research is not only to understand the broad definition of microfinance and its structure and purpose but it is mainly to project the creation of social value by showing and proving how microfinance has been capable in proving itself for the rural dwellers.

II. CONCEPT OF MICRO FINANCE

In India, the history of microfinance dates back to establishment of Syndicate Bank in 1921 in private sector. During the early years, Syndicate Bank concentrated on raising micro deposits in the form of daily/weekly basis and sanctioned micro loans to its clients for shorter period of time. But microfinance came to limelight only when Dr Yunus gave it a mass movement in Grameen Bank experiment.

Microfinance can be called a novel approach to provide saving and investment facility to the poor around world. Improved access and efficient provision of savings, credit, and insurance facilities in particular can enable the poor to smoothen their consumption, manage their risks better, gradually build their asset base, develop their business, enhance their income earning capacity, and enjoy an improved quality of life. In India, microfinance mainly operates through Self Help Group (SHGs), Non Government Organizations(NGOs), and Credit Agencies. It provides poor people with the means to find their own way out of poverty. It put the power squarely in their hands, giving them a larger stake in their own success than one –time donation of food, goods, or cash. The initiatives of Government for poverty alleviation could not succeed to the desired level, may be due to the fact that they do not take cognizance of power of the poor to deal with their own problems. Government tries to help them by way of subsidies and other help but these initiatives hardly reduce their poverty levels and are not a long term solution. This section of society if given with guidance, power of capital and productive assets can emerge as the successful entrepreneur. This can easily be achieved by empowering them with power of microcredit. The poor do not have any worthy asset base.

III. SELF HALF GROUPS (SHGS)

The Self Help Groups (SHGs) is the dominant microfinance methodology in India. In this case the members of Self Help Group pool their small savings regularly at a prefixed amount on daily or weekly basis and SHGs provide loan to members for a period fixed. SHGs are essentially formal and voluntary association of 15 to 20 people formed to attain common objectives. People from homogenous groups and common social back ground and occupation voluntarily form the group and pool their savings for the benefit of all of members of the groups. External financial assistance by MFIs or banks augments the resources available to the group operated revolving fund. Saving thus precede borrowing by the members. NABARD has facilitated and extensively supported a program which entails commercial banks lending directly to SHGs rather than via bulk loan to MFIs. If SHGs are observed to be successful for at least a period of six months, the bank gives credit usually amounting 4 times more than their savings.

IV. GRAMEEN BANK MODEL

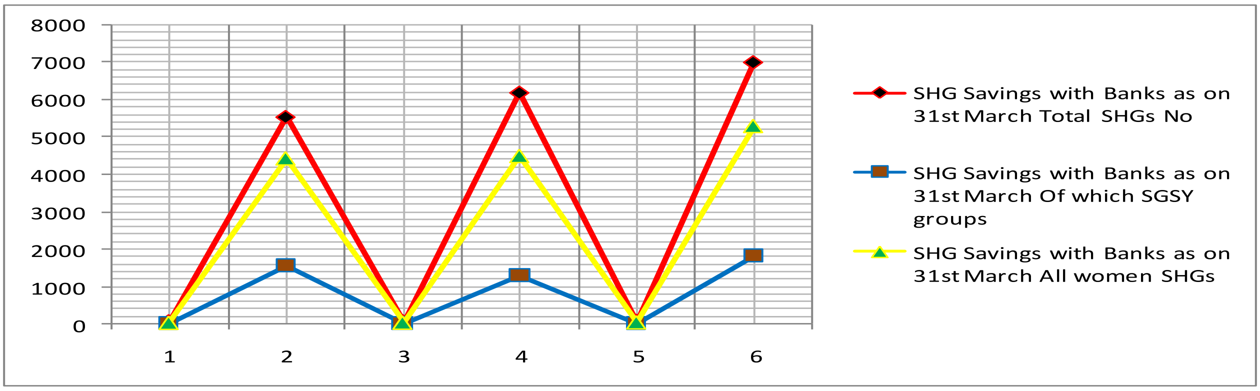
The Grameen Bank model has been a case of exceptional success in Bangladesh. It turns out that many organizations in India have adopted the Grameen Bank model with little variations and good success. Some of the notable examples are SHARE Microfinance Limited, Activists for Social Alternatives (ASA) and CASHPOR Financial and Technical Services Limited. Some of the significant features of Grameen bank model are low transaction costs, no collateral (peer pressure is sufficient), repayment of loans in small and short interval and quick loan sanctions with little or no paper works and no formalities. Repayment of loans in small chunk is one of the major reasons of high loan recovery rate of a Grameen Bank. Furthermore, loans are provided for all purposes like housing loans, sanitation loans, supplementary loans etc. Also the interest rates are nominal making it easy for the poor people to repay their loans timely.

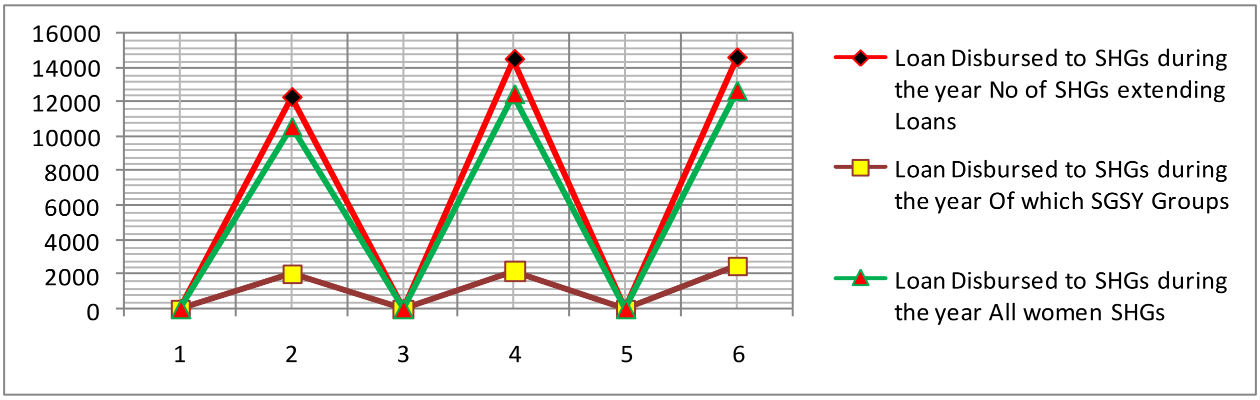
Table 1.1: Overall Progress Under Shg-Bank Linkage

(Amount is in Rupees crore and number in lakhs)

Particular		2011-2012		2012-2013		2013-2014	
		No of SHGs	Amount	No of SHGs	Amount	No of SHGs	Amount
SHG Savings with Banks as on 31st March	Total SHGs No	61.21	5545.62	69.53	6198.71	74.62	7016.3
	Of which SGSY groups	15.06	1563.38	16.94	1292.62	20.23	1817.12
	All women SHGs	48.64	4434.03	53.1	4498.66	60.98	5298.65
Loan Disbursed to SHGs during the year	No of SHGs extending Loans	16.1	12253.51	15.87	14453.3	11.96	14547.7
	Of which SGSY Groups	2.65	2015.22	2.67	2198	2.41	2480.37
	All women SHGs	13.75	10527.38	12.94	12429.37	10.17	12622.3
Loan outstanding Against SHGs as on 31st March	Total No SHGs Linked	42.24	22679.84	48.51	28038.28	47.87	31221.2
	Of which SGSY Groups	9.77	5861.72	12.45	6251.08	12.86	7829.39
	All Women SHGs	32.77	18583.54	38.98	23030.36	39.84	26123.8

Source : *Status of microfinance in India report 2013-14,NABARD*





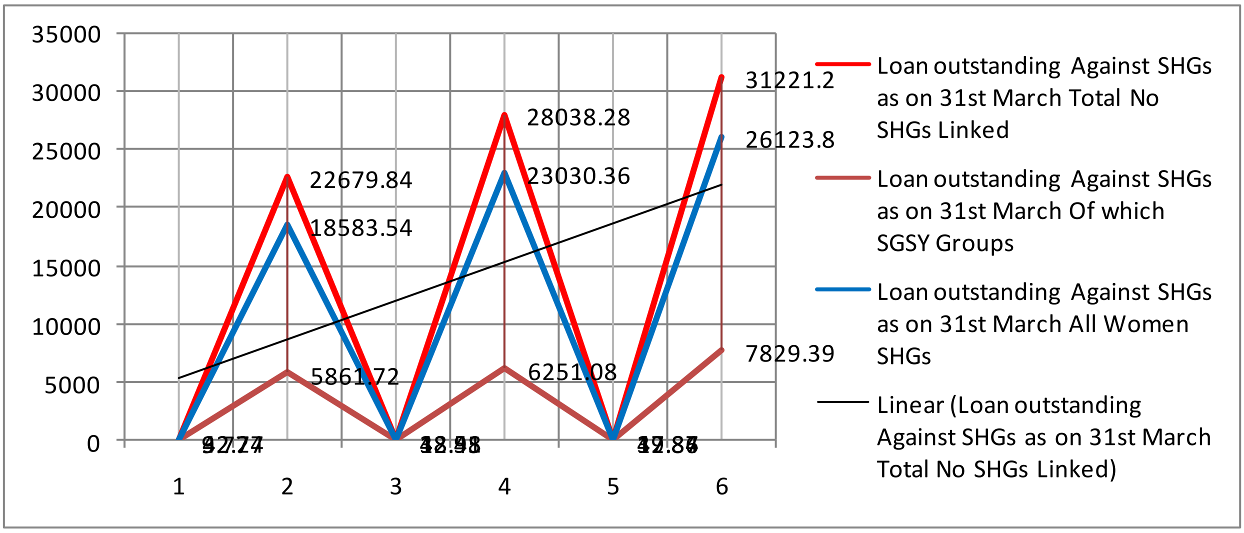
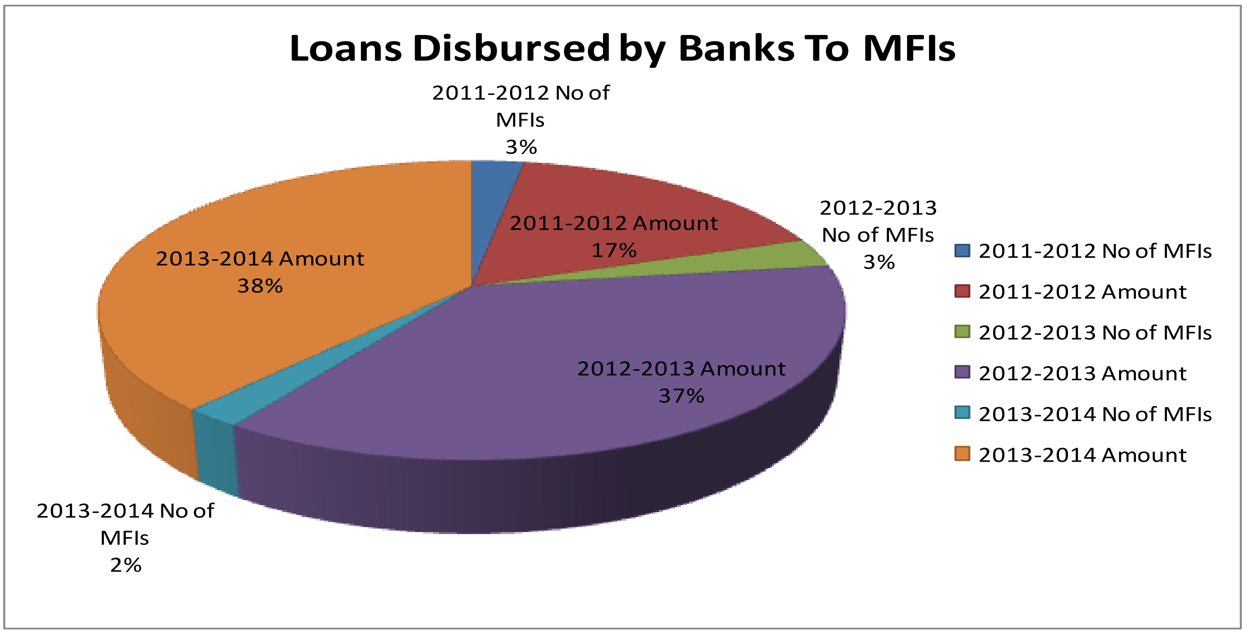


Table 1.2: Progress Under Mfi-Bank Linkage Programme

(Amount is in Rupees crore and number in lakhs)

Particulars	2011-2012		2012-2013		2013-2014	
	No of MFIs	Amount	No of MFIs	Amount	No of MFIs	Amount
Loans Disbursed by Banks To MFIs	581	3732.33	691	8062.74	471	8448.96
Loans outstanding against MFIs as on 31st March	1915	5009.09	1513	10147.54	2315	13730.62

Source : *Status of microfinance in India report 2013-14,NABARD*



Channels of Micro Finance:

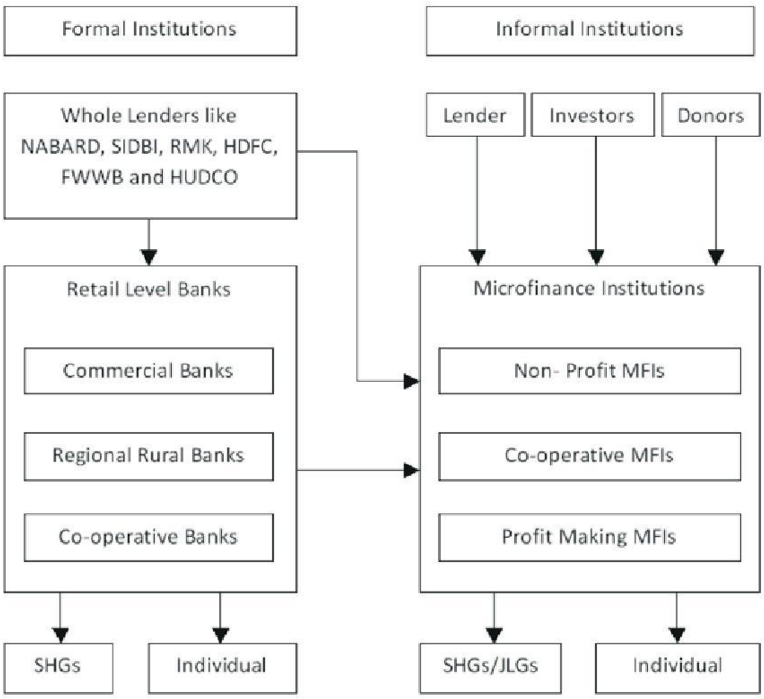
In India Micro Finance operates through two channels:

1. Shg- Bank Linkage Programme (Sblp).
2. Micro Finance Institutions (Mifs).

V. MODES OF DELIVERY OF MICRO FINANCE

Micro Finance Institutions (MFIs) around the world follow a variety of different methodologies. The focus of such service is women rather than men for the reason women are more judicious and economical to men. The following are major methodologies employed by MFIs for delivery of financial services to low income families.

Hierarchy of Financial Institutions for Microfinance Disbursement:



VI. DISCUS ABOUT MICROFINANCE

1. Proper Regulation: The regulation was not a major concern when the microfinance was in its nascent stage and individual institutions were free to bring in innovative operational models. However, as the sector completes almost two decades of age with a high growth trajectory, an enabling regulatory environment that protects interest of stakeholders as well as promotes growth, is needed.

2. Field Supervision: In addition to proper regulation of the microfinance sector, field visits can be adopted as a medium for monitoring the conditions on ground and initiating corrective action if needed. This will keep a check on the performance of ground staff of various MFIs and their recovery practices. This will also encourage MFIs to abide by proper code of conduct and work more efficiently. However, the problem of feasibility and cost involved in physical monitoring of this vast sector remains an issue in this regard.

3. Encourage rural penetration: It has been seen that in lieu of reducing the initial cost, MFIs are opening their branches in places which already have a few MFIs operating. Encouraging MFIs for opening new branches in areas of low microfinance penetration by providing financial assistance will increase the outreach of the microfinance in the state and check multiple lending. This will also increase rural penetration of microfinance in the state.

4. Complete range of Products: MFIs should provide complete range of products including credit, savings, remittance, financial advice and also non-financial services like training and support. As MFIs are acting as a substitute to banks in areas where people don't have access to banks, providing a complete range of products will enable the poor to avail all services.

5. Transparency of Interest rates: As it has been observed that, MFIs are employing different patterns of charging interest rates and a few are also charging additional charges and interest free deposits (a part of the loan amount is kept as deposit on which no interest is paid). All this make the pricing very confusing and hence the borrower feels incompetent in terms of bargaining power. So a common practice for charging interest should be followed by all MFIs so that it makes the sector more competitive and the beneficiary gets the freedom to compare different financial products before buying.

6. Technology to reduce Operating Cost: MFIs should use new technologies and IT tools & applications to reduce their operating costs. Though most NBFCs are adopting such cost cutting measures, which is clearly evident from the low cost per unit money lent (9%-10%) of such institutions. NGOs and Section 25 companies are having a very high value of cost per unit money lent i.e. 15-35 percent and hence such institutions should be encouraged to adopt cost-cutting measures to reduce their operating costs. Also initiatives like development of common MIS and other software for all MFIs can be taken to make the operation more transparent and efficient.

7. Alternative sources of Fund: In absence of adequate funds the growth and the reach of MFIs become restricted and to overcome this problem MFIs should look for other sources for funding their loan portfolio. Some of the ways through which MFIs can raise their fund are:

- **By getting converted to for-profit company i.e. NBFC:** Without investment by outside investors, MFIs are limited to what they can borrow to a multiple of total profits and equity investment. To increase their borrowings further, MFIs need to raise their Equity through outside investors. The first and the most crucial step to receive equity investment are getting converted to for-profit NBFC. Along with the change in status the MFI should also develop strong board, a quality management information system (MIS) and obtain a credit rating to attract potential investors.

- **Portfolio Buyout:** It is when banks or other institutions purchase the rights to future payment stream from a set of outstanding loans granted by MFIs. In such transactions MFIs are responsible for making up any loss in repayment up to a certain percentage of the portfolio and this clause is known as "first loss default guarantee". The above clause ensures that the MFI retains the correct incentive to collect these loans. To ensure security to the buying institution, MFIs are allowed to sell off as much of the outstanding portfolio as is financed by accumulated earnings or equity.

- **Securitization of Loans:** This refers to a transaction in which the repayments from a set of microloans from one or more MFIs are packaged into a special purpose vehicle, from which tradable securities are issued. As the loans from multiple MFIs can be pooled together the risk gets diversified. Though securitization of loans and portfolio buyout are similar in many ways like first loss default guarantee clause, limit to the amount of loans that can be sold off etc. The major difference between the two is that securitizations require a rating from a credit rating agency and that it can be re-sold, which makes securitized loans attract more potential buyers. Also unlike portfolio buyout, there can be multiple buyers and sellers for each transaction in case of securitization of loans as compared to single buyer and single seller in portfolio buyout. Through securitization, MFIs can tap new sources of investments because fund of certain types like mutual funds, which are barred from directly investing in MFIs, can invest through securitized loans.

CONCLUSION

Microfinance is multifaceted and works in an integrated system. There are many stake holders and each one has a definite role to play. In the core there is client. There is a second level called micro level where MFIs, NGOs, SHGs and Grameen work to provide financial support to individual client. Apex institutions like NABARD, SIDBI and other nationalized Banks operate in Meso-Level to provide infrastructure, information and technical support to micro level players. Around all these levels, there are financial environment, Regulations, legislations and regulators called Macro level. With passage of time new opportunities and new challenges are being felt in the field of microfinance. In recent years microfinance is in news for bad reasons. There are a number of suicide cases of micro credit clients all over India for excess interest charges and high handedness of recovery agents in recovery of loans. So, government of India has brought out a legislation to check the high interest rate on micro credit and protect the poor from clutches of greedy MFIs. Government of India introduced Micro Finance Institutions (Development and Regulation) Bill 2012 on May 22, 2012 to establish a regulator under RBI to regulate and supervise the activities of NGOs and MFIs. The main features of the Bill are as follows: the Bill allows the central government to create a Microfinance Development Council with officers from different ministries and Departments. The Bill requires all MFIs to obtain a certificate of registration from RBI. The RBI has the authority to set maximum annual percentage rate charged by MFIs and sets a maximum limit on the margin MFIs can make. Margin is defined as the difference between the lending rate and the cost of funds. It is also responsible for redressal of grievances for beneficiaries of microfinance services. These initiatives may go long way in strengthening the micro finance status in India. Lending to the poor through microcredit is not the end of the problem but beginning of a new era. If effectively handled, it can create miracle in the field of poverty alleviation. But it must be bundled with capacity building programs. Government cannot abdicate its responsibility of social and economic development of poor and down trodden. In absence of any special skills with the clients of microcredit, the fund is being used in consumption and procurement of non-productive assets. Hence it is very important to provide skills development training program like handicraft, weaving, carpentry, poultry, goat rearing, masonry, bees farming, vegetable farming and many other agricultural and non agricultural training. Government has to play proactive role in this case. People with some special skills have to be given priority in lending microcredit. These clients should also be provided with post loan technical and professional aid for success of their microenterprises. If government and MFIs act together then microcredit can play a great role in poverty alleviation.

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