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STREAMLINING THE MICROFINANCE SECTOR IN INDIA THROUGH SOME REGULATORY MEASURES

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ABSTRACT The Author made an attempt to analyze the role of micro finance sector and how it can be streamlined through some regulatory measures of RBI. Microfinance is an economic development tool whose objective is to assist the poor to work their way out of poverty. It covers a range of services which include, in addition to the provision of credit, many other services such as savings, insurance, money transfers, counseling, etc.

KEYWORDS : Regulatory measures – MFI – RBI – Enhancing Measures.

INTRODUCTION

The SHG-Bank Linkage Model was pioneered by NABARD in 1992. Under this model, women in a village are encouraged to form a Self help Group (SHG) and members of the Group regularly contribute small savings to the Group. These savings which form an ever growing nucleus are lent by the group to members, and are later supplemented by loans provided by banks for income-generating activities and other purposes for sustainable livelihood promotion. The Group has weekly/ monthly meetings at which new savings come in, and recoveries are made from members towards their loans from the SHGs, their federations, and banks. NABARD provides grants, training and capacity building assistance to Self Help Promoting Institutions (SHPI), which in turn act as facilitators/ intermediaries for the formation and credit linkage of the SHGs.

Under the NBFC model, NBFCs encourage villagers to form Joint Liability Groups (JLG) and give loans to the individual members of the JLG. The individual loans are jointly and severally guaranteed by the other members of the Group. Many of the NBFCs operating this model started off as non-profit entities providing micro-credit and other services to the poor. However, as they found themselves unable to raise adequate resources for a rapid growth of the activity, they converted themselves into for-profit NBFCs. Others entered the field directly as for-profit NBFCs seeing this as a viable business proposition. Significant amounts of private equity funds have consequently been attracted to this sector.

THE NEED FOR REGULATION

All NBFCs are currently regulated by Reserve Bank under Chapters III-B, III-C and V of the Reserve Bank of India Act. There is, however, no separate category created for NBFCs operating in the Microfinance sector. The need for a separate category of NBFCs operating in the Microfinance sector arises for a number of reasons.

First, the borrowers in the Microfinance sector represent a particularly vulnerable section of society. They lack individual bargaining power, have inadequate financial literacy and live in an environment which is fragile and exposed to external shocks which they are ill-equipped to absorb. They can, therefore, be easily exploited.

Second, NBFCs operating in the Microfinance sector not only compete amongst themselves but also directly compete with the SHG-Bank Linkage Programme. The practices they adopt could have an adverse impact on the programme. In a representation made to the Sub-Committee by the Government of Andhra Pradesh, it has been argued, that the MFIs are riding "piggy-back" on the SHG infrastructure created by the programme and that JLGs are being formed by poaching members from existing SHGs. About 30% of MFI loans are purportedly in Andhra Pradesh.

The Microfinance in India- A State of Sector Report 2010 also says that there are many reports of SHGs splitting and becoming JLGs to avail of loans from MFIs. The A.P. Government has also stated that as the loans given by MFIs are of shorter duration than the loans given under the programme, recoveries by SHGs are adversely affected and loans given by the SHGs are being used to repay loans given by MFIs. While we did not, as committee, examine each of these issues in depth, the fact that these complaints have been made reinforces the need for a separate and focused regulation.

For the purposes of this report, the Sub-Committee has confined itself to only one aspect of Microfinance, namely, the provision of credit to low-income groups. The provision of credit to the Microfinance sector is based on the following postulates:

- It addresses the concerns of poverty alleviation by enabling the poor to work their way out of poverty.
- It provides credit to that section of society that is unable to obtain credit at reasonable rates from traditional sources.
- It enables women's empowerment by routing credit directly to women, thereby enhancing their status within their families, the community and society at large.
- Easy access to credit is more important for the poor than cheaper credit which might involve lengthy bureaucratic procedures and delays.
- The poor are often not in a position to offer collateral to secure the credit.
- Given the imperfect market in which the sector operates and the small size of individual loans, high transaction costs are unavoidable. However, when communities set up their own institutions, such as SHG federations and cooperatives the transaction costs are lower.
- Transaction costs, can be reduced through economies of scale. However, increases in scale cannot be achieved, both for individual operations and for the sector as a whole in the absence of cost recovery and profit incentive.

Given the above considerations, the essential features of credit for Microfinance which have evolved are as under:-

- The borrowers are low-income groups.
- The loans are for small amounts.
- The loans are without collateral.
- The loans are generally taken for income-generating activities, although loans are also provided for consumption, housing and other purposes.
- The tenure of the loans is short.
- The frequency of repayments is greater than for traditional commercial loans.

THE PLAYERS IN THE MICROFINANCE SECTOR CAN BE CLASSIFIED AS FALLING INTO THREE MAIN GROUPS

1) The SHG-Bank linkage Model accounting for about 58% of the outstanding loan portfolio.
2) Non-Banking Finance Companies accounting for about 34% of the outstanding loan portfolio.

3) Others including trusts, societies, etc, accounting for the balance 8% of the outstanding loan portfolio. Primary Agricultural Co-operative Societies numbering 95,663, covering every village in the country, with a combined membership of over 13 crores and loans outstanding of over `64, 044 crores as on 31.03.09 have a much longer history and are under a different regulatory framework. Thrift and credit co-operatives are scattered across the country and there is no centralized information available about them.

Thirdly, credit to the Microfinance sector is an important plank in the scheme for financial inclusion. A fair and adequate regulation of NBFCs will encourage the growth of this sector while adequately protecting the interests of the borrowers.

Fourth, over 75% of the finance obtained by NBFCs operating in this sector is provided by banks and financial institutions including SIDBI. As at 31stMarch 2010, the aggregate amount outstanding in respect of loans granted by banks and SIDBI to NBFCs operating in the Microfinance sector amounted to `13,800 crores. In addition, banks were holding securitized paper issued by NBFCs for an amount of `4200 crores. Banks and Financial Institutions including SBIDBI also had made investments in the equity of such NBFCs. Though this exposure may not be significant in the context of the total assets of the banking system, it is increasing rapidly.

Finally, given the need to encourage the growth of the Microfinance sector and the vulnerable nature of the borrowers in the sector, there may be a need to give special facilities or dispensation to NBFCs operating in this sector, alongside an appropriate regulatory framework. This will be facilitated if a separate category of NBFCs is created for this purpose.

REGULATIONS TO BE SPECIFIED

A study of 9 large and 2 small NBFC-MFIs shows that loans constitute an average of 95% of total assets (excluding cash and bank balances and money market instruments). We may, therefore, accept that a NBFC pre-dominantly provides financial services to the Microfinance sector if its loans to the sector constitute not less than 90% of its total assets (excluding cash and bank balances and money market instruments). It is also necessary to specify that a NBFC which is not a NBFC-MFI shall not be permitted to have loans to the Microfinance sector which exceed 10% of its total assets.

Most MFIs consider a low-income borrower as a borrower who belongs to a household whose annual income does not exceed `50,000/-. This is a reasonable definition and can be accepted.

a) Currently, most MFIs give individual loans which are between `10,000 and `15,000. However, some large NBFCs also give larger loans, even in excess of `50,000 for special purposes like micro-enterprises, housing and education.
b) It is important to restrict the size of individual loans as larger loans can lead to over-borrowing, diversion of funds and size of repayment installments which are beyond the repayment capacity of the borrower.
c) It is, therefore, suggested that the size of an individual loan should be restricted to `25,000. Further, to prevent over-borrowing, the aggregate value of all outstanding loans of an individual borrower should also be restricted to `25,000.

MFIs normally give loans which are repayable within 12 months irrespective of the amount of the loan. However, the larger the loan, the larger the amount of the repayment installment, and a large installment may strain the repayment capacity of the borrower and result in ever greening or multiple borrowing. At the same time, if the repayment installment is too small, it would leave cash with the borrower which could be directed to other uses and not be available for repayment when repayment is due.

There has, therefore, to be a linkage between the amount of the loan and the tenure of the loan. It is, therefore, suggested that for loans not exceeding `15,000, the tenure of the loan should not be less than 12 months and for other loans the tenure should not be less than 24 months. The borrower should however have the right of prepayment in all cases without attracting penalty.

Low-income borrowers often do not have assets which they can offer as collateral, and it is important to ensure that in the event of default, the borrower does not lose possession of assets which s/he may need for her/his continued existence.

It is, therefore, suggested that all loans should be without collateral. It is often argued that loans should not be restricted to income generating activities but should also be given for other purposes such as repayment of high-cost loans to moneylenders, education, medical expenses, consumption smoothing, acquisition of household assets, housing, emergencies, etc. A recent study by Centre for Microfinance of borrowers in Hyderabad indicates that Microfinance is useful in smoothening consumption and relieving seasonal liquidity crises that visit poor families and that it obviates the need for high-cost borrowing from informal sources.

CONCLUDING REMARKS

The need for loans for the above purposes cannot be denied. At the same time there are powerful arguments why loans by NBFC-MFIs should be confined to income-generating activities.

- Firstly, the main objective of NBFC-MFIs should be to enable borrowers, particularly women to work their way out of poverty by undertaking activities which generate additional income. This additional income, after repayment of the loan and interest, should provide a surplus which can augment the household income, enable consumption smoothing and reduce dependence on the moneylender.
- Secondly, if the loans are not used for repayment of high-cost borrowing, but are used for consumption, they will in fact add to the financial burden of the household as there will be no additional source from which the loan and interest thereon can be repaid.
- Thirdly, borrowing for non-income generating purposes may tempt borrowers to borrow in excess of their repayment capacity.
- Finally, if there is no identified source from which interest and installment can be paid, the rate of delinquency will increase. This additional cost will push interest rates upwards and may even result in the use of more coercive methods of recovery.

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