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Role of Micro Finance in India–A Study

KEYWORDS: Micro finance, micro credit, financial service

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ABSTRACT *Traditionally, banks have not provided financial services, such as loans, to clients with little or no cash income. This is especially true in developing economies that lack a strong financial system. So poor people borrow and often rely on relatives or a local moneylender, whose interest rates can be very high. But now, the world of microfinance opens the door of opportunity for the poor. It helps create stability at home, teaches individuals how to thrive, and fosters self-respect and community well-being. With financial inclusion emerging as a major policy objective in the country, micro-finance has occupied centre stage as a promising conduit for extending financial services for needed people. The present paper focuses on the concept of micro finance and its need in India. Further the paper concentrates on different delivery models and obstacles of micro finance.*

INTRODUCTION
Microfinance has captured the imaginations of many people working to reduce poverty.

Microfinance is defined as any activity that includes the provision of financial services such as credit, savings, and insurance to low income individuals which fall just above the nationally defined poverty line, and poor individuals which fall below that poverty line, with the goal of creating social value. The creation of social value includes poverty alleviation and the broader impact of improving livelihood opportunities through the provision of capital for micro enterprise, and insurance and savings for risk mitigation and consumption smoothing. A large variety of sectors provide microfinance in India, using a range of microfinance delivery methods. Since the ICICI Bank in India, various actors have endeavored to provide access to financial services to the poor in creative ways. Governments also have piloted national programs, NGOs have undertaken the activity of raising donor funds for on-lending, and some banks have partnered with public organizations or made small inroads themselves in providing such services. This has resulted in a rather broad definition of microfinance as any activity that targets poor and low-income individuals for the provision of financial services. The range of activities undertaken in microfinance include group lending, individual lending, the provision of savings and insurance, capacity building, and agricultural business development services. Whatever the form of activity however, the overarching goal that unifies all actors in the provision of microfinance is the creation of social value.

OBJECTIVES OF THE STUDY
1. To know the concept of micro finance.

2. To study the evolution of micro finance in India.

3. To give suggestions so that micro finance could reach the target segment effectively.

CONCEPT OF MICRO FINANCE
According **to International Labor Organization (ILO),** "Microfinance is an economic development approach that involves providing financial services through institutions to low income clients".

In India, Microfinance has been defined by **"The National Microfinance Taskforce, 1999"** as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards".

Schreiner and Colombet (2001, p.339) define microfinance as "the attempt to improve access to small deposits and small loans for poor households neglected by banks."

Micro Finance is defined as, financial services such as Saving A/c, Insurance Fund & credit provided to poor & low income clients so as to help them to rise their income & there by improve their standard of living.

"The poor stay poor, not because they are lazy but because they have no access to capital."

"The job of government is to enable financial services, not to provide them."

- "Donor funds should complement private capital, not compete with it."

- "The key bottleneck is the shortage of strong institutions and managers." Donors should focus on capacity building.

- Interest rate ceilings hurt poor people by preventing microfinance institutions from covering their costs, which chokes off the supply of credit.

- Microfinance institutions should measure and disclose their performance – both financially and socially.

MICRO FINANCE IN INDIA
Loans to poor people by banks have many limitations including lack of security and high operating cost. So Microfinance was developed as an alternative to provide loans to poor people with the goal of creating financial inclusion and equality.

Muhammad Yunus a Nobel Prize winner introduced the concept of Microfinance in Bangladesh in the form of the "Grameena Bank". NABARD took this idea and started concept of Micro Finance in India

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EVOLUTION OF MICROFINANCE IN INDIA (1960 TO TODAY)
Microfinance in India emerged as an effort to reach out to the un-banked, lower income segments of the population

1960 to 1980	1990	2000
Phase 1: Social Banking	Phase 2: Financial Systems Approach	Phase 3: Financial Inclusion
1.Nationalization of private commercial banks 2.Expansion of rural branch network 3.Extension of subsidized credit 4.Establishment of Rural Regional Banks	1.Peer-pressure 2.Establishment of MFIs, typically of non-profit origins	1.NGO-MFIs and SHGs gaining more legitimacy 2.MFIs emerging as strategic partners to diverse entities interested in the low-income segments 3.Consumer finance emerged as high growth area 4.Increased policy regulation
5.Establishment of apex institutions such as National Bank for Agriculture and Rural Development and Small Industries Development Bank of India		5.Increasing commercialization

- **Phase 1:** In the 1960's, the credit delivery system in rural India was largely dominated by the cooperative segment. The period between 1960 and 1990, referred to as the "social banking" phase. This phase includes nationalization of private commercial banks, expansion of rural branch networks, extension of subsidized credit, establishment of Regional Rural Banks (RRBs) and the establishment of apex institutions such as the National Bank for Agriculture and Rural Development (NABARD) and the Small scale Industries Development Board of India (SIDBI).

- **Phase 2:** After 1990, India witnessed the second phase "financial system approach" of credit delivery. In this phase NABARD initiated the Self Help Group (SHG) - Bank Linkage Bank Linkage program, which links informal women's groups to formal banks. This concept held great appeal for non-government organizations (NGOs) working with the poor, prompting many of them to collaborate with NABARD in the program. This period also witnessed the entry of Microfinance Institutions (MFIs), largely of non-profit origins, with existing development programs.

- **Phase 3:** In 2000, the third phase in the development of Indian microfinance began, marked by further changes in policies, operating formats, and stakeholder orientations in the financial services space. This phase emphasizes on "inclusive growth" and "financial inclusion." This period also saw many NGO-MFIs transform into regulated legal formats such as Non-Banking Finance Companies (NBFCs). Commercial banks adopted innovative ways of partnering with NGO-MFIs and other rural organizations to extend their reach into rural markets. MFIs have emerged as strategic partners to individuals and entities interested in reaching out to India's low income client segments.

REASONS FOR GROWTH OF MICROFINANCE
Microfinance is growing for several reasons:

- **The promise of reaching the poor**

activities can support income generation for enterprises operated by low-income households.

- **The promise of financial sustainability**

Microfinance activities can help to build financially self-sufficient, subsidy-free, often locally managed institutions.

- **The potential to build on traditional systems**

Microfinance activities sometimes mimic traditional systems (such as rotating savings and credit associations). They provide the same services in similar ways, but with greater flexibility, at a more affordable price to microenterprises and on a more sustainable basis. This can make microfinance services very attractive to a large number of low-income clients.

- **The contribution of microfinance to strengthening and expanding existing formal financial systems**

Microfinance activities can strengthen existing formal financial institutions, such as savings and loan cooperatives, credit union networks, commercial banks, and even state-run financial institutions, by expanding their markets for both savings and credit—and, potentially, their profitability.

OBSTACLES IN THE GROWTH OF THE MICRO FINANCE

1. One of the major hindrances in the growth of the microfinance sector is the financial illiteracy of the people. This makes it difficult in creating awareness of microfinance and even more difficult to serve them as microfinance clients.
2. Inability of MFIs to raise sufficient fund remains one of the important concern in the microfinance sector. Though NBFCs are able to raise funds through private equity investments because of the for-profit motive, such MFIs are restricted from taking public deposits.
3. Majority of the microfinance loans are disbursed on group lending concept and a past record of the group plays an important role in getting new loans either through SHG-Bank linkage or through MFIs. The two major problems with the group concept are dropouts (when one or more members leave the group) and migration (when one or more members move to another group).
4. Non-transparent pricing by MFIs confines the bargaining power of the borrowers and their ability to compare different loan products, because they don't know the actual price. In absence of the proper understanding of the pricing, clients end up borrowing more than their ability to payback which results in over-indebtedness of the borrower.

SUGGESTIONS

1. An enabling regulatory environment that protects interest of stakeholders as well as promotes growth is needed.
2. 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.
3. 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.
4. MFIs should provide complete range of products including credit, savings, remittance, financial advice and also non-financial services like training and support.
5. 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.

CONCLUSION
The concept has grown over the past two decades. Over the years, major commercial banks and multinational corporations have decided to sponsor it. However, this type of financing has a darker side too. Most of studies are qualitative which tell that more than 90 per cent of the people who receive micro credit are poor and most of them succeed in businesses started with these loans. But the suicides committed by Indian farmers after being harassed by the microfinance institutions (MFIs) for their inability to repay the debt have raised serious moral and ethical issues against the institutions. The aggressive debt-collection tactics of these MFIs have left us wondering if the government has been playing ignorant to the modus operandi of MFIs. Moreover, the interest rates charged by micro financing institutions are usurious.

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