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Spreading of Microfinance in India: Some Challenges

KEYWORDS: Microfinance, Self Help Groups, Micro Finance Institutions, Micro Credit, Non-bank Financial Institutions.

Ch.Sujatha Gangadhar

Registrar, Jawaharlal Nehru Institute of Advanced Studies (JNIAS), 6th Floor, Buddha Bhawan, M.G Road, Secunderabad, Telangana - 500003.

Prof.P.Malyadri

Principal, Government Degree College, Osmania University, Andhra Pradesh, India & Honorary Professor, School of Management & Training, JNIAS, Secunderabad.

ABSTRACT *The term microfinance covers the provision of financial services as a whole to the poor which includes microcredit, micro-insurance and savings. It is the system of providing very small loans without a collateral to low income individuals and households that are repaid within short periods of time. Microfinance has evolved over years and now a proven strategy for reaching the poorest of the poor. However, the Microfinance Institutions face a variety of challenges in its delivery of micro finance services. This paper is an attempt to understand the evolution of the microfinance industry in India and to underline the critical challenges faced in the spread of Microfinance in India. The paper is also intended to provide suggested solutions to help deal with these challenges. The present scenario of the microfinance sector in India, its history as well its future direction have been highlighted.*

I. Introduction

The Microfinance industry in India was initiated in order to help poor people. Credit in small doses enables the poor to manage their risks and come out of poverty. The poor need credit in small doses at irregular times which are urgent in nature (Nageshwar Rao P, 2012). The loans were initially targeted to help Self Help Groups (SHG's) in the rural areas of India. The SHG's are comprised of 10 to 20 women and they are emblematic of the micro loan sector in India. The SHG - Bank Linkage Programme is a major plank of the strategy for delivering sustainable financial services to the poor in India (Mathur T.N, 2013). Bank lending to SHG's is stimulated both by the support of National Bank for Agricultural and Rural Development (NABARD) and national policies for priority sector lending. SHG–Bank Linkage Programme was launched way back in 1992 by NABARD envisaging integration of formal financial system and informal sector (Uma Narang 2012). Since then it has become a movement throughout the country, and is considered today as the largest microfinance programme in terms of its spread and outreach in the world (Malyadri .P, 2011). In 2010, 4.5 million SHG's with 58 million members received credit in India. In the recent past, the incessant increase in the growth of Microfinance Institutions and their objectionable ways in which they expanded their credit outreach could not make any significant impact in the popularity of the SHG-Bank Linkage programme.

The regulatory framework for microfinance in India is not unified. Microfinance is provided by commercial banks, Regional Rural Banks (RRBs), the SHG's, cooperative societies and institutions (MFIs) that take various forms, including those of NGO's and Non-Bank Financial Institutions (NBFI's). Banks and NBFI's are governed by the Reserve Bank of India (RBI), SHGs are regulated by NABARD, the cooperatives are governed by Registrar of Cooperative Societies (RCS) etc. All MFIs are not registered and they are not all under the same regulations (Wright & Sharma, 2010).

II. Objectives of the paper

1. To evaluate the growth of Microfinance in India.
2. To identify the critical challenges in the spread of Microfinance programmes.
3. To suggest ways and measures to meet the above challenges.

III. Overview of the growth of microfinance in India:

Microfinance has been popular in India for quite some time, especially in the rural areas. A study by Consultative Group to Assist the Poor (CGAP) showed that countries with higher poverty rates have the lowest penetration of deposit accounts per 100 adults. Specifically, 70% of adults in developing countries are still excluded from the regulated financial system (CGAP, 2010).

Till recently, Andhra Pradesh used to be the hub for microfinance. Microfinance options were highly in demand. However, the scenario has changed due to the microfinance crisis. This crisis got initiated at Andhra Pradesh itself, as this State had the maximum number of microfinance borrowers. Today, Andhra Pradesh is only next to the Bangladesh as the most microfinance 'saturated' place with nearly 17% of the population having micro loan accounts (Malyadri. P, 2011). The State Government took measures to control the collection methods used by banks to get back the money they had lent as microfinance. This made it difficult for the banks to recover the money they had lent. The various microfinance organizations faced a lot of criticism due to the aggression of their recovery procedures. They were also blamed for taking excessive charge from customers in terms of interest. This created a huge negative reputation for the microfinance industry in India and created a major setback for the industry, from which, it is still trying to recover from. The steps taken by the government of Andhra Pradesh restricted the access of these organizations to credits.

The growth of MF industry in the past few years can be understood by the following trends:

(a) Growth Index of MFI's:

The M-CRIL India MFI growth Index measures the performance of the 24 largest MFI's in the country. It uses the

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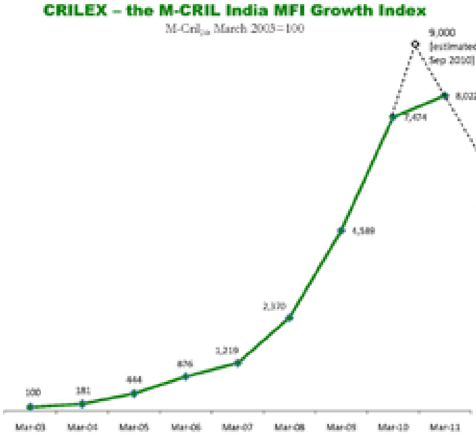
information on the number of borrowers and the size of the loan portfolio of each of the 24 MFI's with more than 100000 active borrowers.

Table 1 (about here)

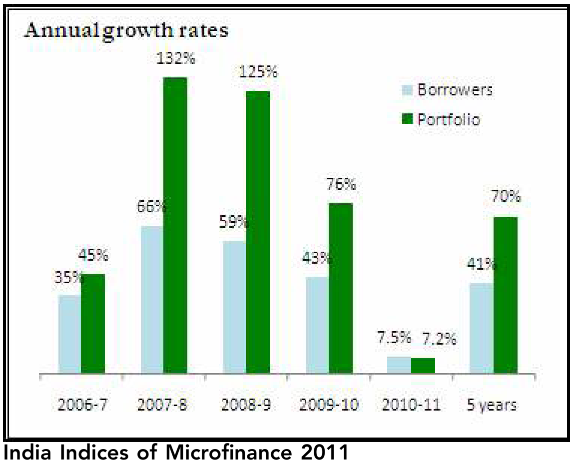


M-CRIL India MFI Growth Index:
Source: www.m-cril.com.

Above diagram reflects the increasing trend of growth till 2010 and subsequent decline to a very low level in 2010-11.

(b) Annual Growth Rates of MFI's:
The diagram below reflects the annual growth rate of borrowers and loan portfolio for the period 2006 to 2011. It can be seen that the growth trend has not been even and was greatly reduced from 43% and 76% growth in 2009-10 to just 7.5% for borrowers and 7.2% for loan portfolio in the year 2010-11.

Table 2 (about here)



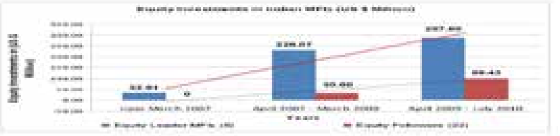
India Indices of Microfinance 2011
Source: www.indiamicrofinance.com

(c) Equity Investments in MFI's:
A recent phenomenon in the field of microfinance is the emergence of foreign direct investment in Indian MFIs. As many new MFIs are showing positive returns, microfinance is being viewed by many equity investors as a viable and profitable investment opportunity (Rajdeep Sengupta, 2008). MFIs have attracted equity investors and private capital as never before. Private equity and specialized microfinance investors had invested in 17 deals in the FY 2009, valued at INR 867 Crores. In the first half of 2010, 14 deals have already raised over US$ 300m as equity investments. Much of this capital is backed by aggressive growth plans laid out by the management of MFIs with a clear focus on financial bottom lines (Shabana G, 2011).

There has been an emergence of cross border acquisitions and strategic partnerships between the microfinance institutions in India and other countries. Over the past few years, microfinance has evolved as one of the fastest-growing sectors globally, as an estimated US$5 billion of cross-border investments have poured from the developed world into microfinance institutions worldwide. By the end of 2010, the global MFIs made around $12bn investment and the major part of it is on the MFIs in India.

The equity investment in leading microfinance institutions in India up to March 2007 was $32.51million and it has been increased to $228.87million in March 2009. The amount of investments in leading microfinance institutions has been increased to $ 287.88 million in July 2010. The investments in small microfinance institutions which are referred as equity followers have also increased significantly in 2010 as compared to 2009.

Table 3 (about here)



Equity Investments in MFIs in India
Source: www.tilt.ft.com

(d) Spread of Microfinance Institutions:
The Microfinance institutions in India exist as NGOs, Section 25 companies, Non Banking Financial Companies (NBFC's), Commercial Banks, Regional Rural Banks (RRB's) and Cooperative Societies. In spite of the current crisis, there have been many developments in the field of Microfinance in India. Some major public sector banks such as Bank of Baroda, Indian Bank signed contracts with major MFIs in order to rein the interest rates and it ensures that the MFIs cannot charge interest rates beyond a certain limit. There are many MFIs who made partnerships with regional banks. As per the data from the last financial year, there are around 82 regional rural banks with a network of 15475 branches spread over 620 districts in 26 states and one union territory. The finance ministry also directed the RRBs to open around 2000 branches within a year. So, partnership with the RRBs seemed to be fruitful for the microfinance institutions in India. The new regulations developed by government also helped the MFIs to grow in India.

IV. Challenges faced in the growth of microfinance:
Microfinance has emerged as a key instrument of financial inclusion, not only in India but in the entire developing world (Dinesha PT, 2010). The growth of microfinance institutions in India is quite good in recent years. The microfinance institutions in India have evolved into a vibrant industry exhibiting a variety of business models.

However, few challenges in the spread of microfinance in India include:

- **Rural Vs Urban Poor:**

Most of the microfinance institutions pay more attention to

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the rural areas and they neglect the poor people living in the urban areas. Out of the total 800 microfinance organizations operating their business in India, only six of them have been able to concentrate on the urban poor. The population of urban poor is quite huge in India and it is like 100 million and this number is expected to rise rapidly in the coming years. The microfinance institutions need to focus on the urban poor people too. There are many established finance institutions ranging from banks, private lenders in urban areas in India who lend money to the individuals and most of the people trust them a lot. So, it is quite difficult for the microfinance institutions to start their business in the urban areas.

- **Scale of operations:**

In order to achieve sustainability it is important to increase the scale of microfinance operations and outreach. In India, the microfinance outreach is very low which is only 5% compared to 65% in Bangladesh. The increase in the size and scale of operations of MFI's will help in sustaining the default risk and reduce the operational costs per borrower.

- **Uncertainty and default risk:**

Uncertainty and default risk are the major challenges faced by the Microfinance institutions in India. Most of the rural people in India have volatile and irregular income and their expenditure patterns are very bad. The rural people in India are highly exposed to the systematic risks like the crop failures or the fall in the commodity prices and as a result, they face difficulties while servicing the loans. So, the microfinance institutions have legitimate concerns when they are dealing with the poor people living in the rural areas and they tend to perceive the loans very risky.

- **Lack of security / collateral for Micro- loans:**

Government of India has not been able to design and implement an effective and strong and regulatory framework which is conducive to the growth of Microfinance Institutions in India. As a result, the contract design, contract enforcement and contract re-negotiation of MFI's is quite weak. It makes the microfinance institutions quite difficult to provide any right incentive for the repayment of the loan. The securitization and asset reconstruction law helped to improve the legal framework to recover the bad loans and the out of court settlements have also been introduced. The ownership, the title and the process of registration of lands is quite weak in rural areas. So, the MFIs often face challenges when they require the collateral from the borrowers.

- **Lack of policy planning:**

The regulatory and financial policies of the Government in India are also not so strong and there are various gaps in the policies announced by it and the policies often end up with higher financial risk for the MFIs. The risks can be like high fiscal deficits, interest rate policies and improper credit planning policy of RBI etc.

- **Profit Motive:**

A paradigm shift in the focus of the MFI's from "social motive" to "profit motive" has led to emergence of "For Profit MFI's" in the recent years. This change in focus is putting a lot of stress on the managements of the MFI's to show increased growth and astounding loan portfolios. Since these MFI's have equity participation from fund managers and private individuals, they are faced with increased competition to show financial growth and improved rate of return.

The new MFIs have created the appearance of being far more concerned about doing well financially than in doing good for clients, community and nation. (Shabana, G (2011).

V. Addressing the challenges:

Women have a better sense of responsibility as compared to men, and hence, 95% of micro-loans in India are given to women groups. But, the present system of micro loans needs to change and be more appealing to individuals and not just group centric.

Following are few ways that may be followed by the MFIs to address the above challenges:

- **Setting up of achievable targets for profit and growth:**

The MFI's should identify and set reasonable and achievable growth targets for profit and return on investments. The over enthusiasm of the few managements to project and achieve more than normal targets in growth and profit leads to collapse of the basic premise of social motive on which the edifice of MFI industry is based.

- **Effective utilisation of microloans:**

The MFI's need to ensure that micro loans are utilized for productive purposes or employment generation activities and not utilized for repayment of existing loans. The cycle of servicing multiple loans by the poor without any addition to their income engulfs them into the vicious circle of continuous debt leading to risk of default. The MFI's need to communicate and bring awareness about the risks of inappropriate utilization and deployment of the loans for consumption purpose by the borrowers.

Generally, the income rich households take more credit for investment purpose and less for consumption purpose as compared to the income poor households (Dinesha P.T, (2010).

- **Flexible repayment options:**

The microfinance organizations should provide repayment options with enhanced flexibility. It should try to understand the perspective of the customer. For example, the farmers who take micro loans should be allowed to repay the money after they have harvested their crops in the cropping season, instead of the standard system of weekly repayments.

- **Framing policies and regulations:**

It is very important to formulate and implement clear and unambiguous policies to enable easier operation and regulation of Microfinance institutions in India. This has to be done on urgent basis and the Government of India should play a vital role in establishing the enabling policy, legal and regulatory framework for the MFIs.

- **Liberal norms for granting loans:**

Loans should be such that they can be availed by men as well. The loans need to be made more accessible without compromising on the surety of recovery. This can be achieved by involving women as well as men in a loan process. For example, giving a micro loan to a household instead of a group of men or women, or any individuals, can be a good option.

- **Clear targeting of clients:**

The MFIs should ensure that the borrowers are authentic and they repay the loans without any fail. Appropriate services and products and good staffing is quite essential to

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ensure the effectiveness. MFIs should focus on the quality of the groups participating in the credit programmes and the importance of financial sustainability of the groups.

VI. Conclusion:

Many analysts argue in favour of an effective implementation of measures to protect customers, including transparency of interest rates and control of over-indebtedness through credit bureaus. It is very difficult to control the identity of borrowers or to identify informal loans. The long-term viability of institutions is based both on shareholder value and the value proposition to customers. It is important to make sure that, shareholders, executives and incentive systems ensure this double perspective. The regulation should ensure the right balance between promoting financial inclusion and safeguarding the interests of consumers. Credit crisis should be prevented at all costs. At a time when a growing number of microfinance markets reached an advanced stage of maturity, the industry must consider the effective means to promote a sustainable microfinance model for its customers.

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