

Detail Analysis of Micro Finance Sector.



Management

KEYWORDS : Micro Finance, Financial Inclusion, Macro Finance, Banking Industry.

J.K.Tandon

Prof. Research Guide, JNU, Jaipur

Jayendra Chaturvedi

Research Scholar, JNU, Jaipur.

Jyoti Chaturvedi

Research Scholar, JNU, Jaipur.

ABSTRACT

Microfinance sector has grown rapidly over the past few decades. Nobel Laureate Muhammad Yunus is credited with laying the foundation of the modern MFIs with establishment of Grameen Bank, Bangladesh in 1976. Today it has evolved into a vibrant industry exhibiting a variety of business models. Microfinance Institutions (MFIs) in India exist as NGOs (registered as societies or trusts), Section 25 companies and Non-Banking Financial Companies (NBFCs). Commercial Banks, Regional Rural Banks (RRBs), cooperative societies and other large lenders have played an important role in providing refinance facility to MFIs. Banks have also leveraged the Self-Help Group (SHGs) channel to provide direct credit to group borrowers.

This Paper involved study of the past literatures about the microfinance sector, related online research papers and journals. The study also involved survey of all MFIs in the state of Rajasthan and Uttar Pradesh through field visits and online survey. The annual reports and the sector reports published by regulatory bodies, MFI associations and major microfinance players facilitated the study, especially in understanding the size, growth and past trends. Interactions with some of the industry experts helped in understanding and analysing the emerging concerns in the microfinance sector and also to look for some possible solutions.

Introduction:

"Microfinance is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services." Microfinance is not just about giving micro credit to the poor rather it is an economic development tool whose objective is to assist poor to work their way out of poverty. It covers a wide range of services like credit, savings, insurance, remittance and also non-financial services like training, counselling etc.

Although the microfinance sector is having a healthy growth rate, there have been a number of concerns related to the sector, like grey areas in regulation, transparent pricing, low financial literacy etc. In addition to these concerns there are a few emerging concerns like cluster formation, insufficient funds, multiple lending and over-indebtedness which are arising because of the increasing competition among the MFIs. On a national level there has been a spate of actions taken to strengthen the regulation of MF sector including, enactment of microfinance regulation bill by the Government of Andhra Pradesh, implementation of sector-specific regulation by Reserve Bank of India and most recently, release of Draft Microfinance Institutions (development and regulation) Bill, 2011 for comments.

Salient features of Microfinance:

- Borrowers are from the low income group
- Loans are of small amount – micro loans
- Short duration loans
- Loans are offered without collaterals
- High frequency of repayment
- Loans are generally taken for income generation purpose

Gaps in Financial system and Need for Microfinance:

According to the latest research done by the World Bank, India is home to almost one third of the world's poor (surviving on an equivalent of one dollar a day). Though many central government and state government poverty alleviation programs are currently active in India, microfinance plays a major contributor to financial inclusion. In the past few decades it has helped out remarkably in eradicating poverty. Reports show that people who have taken microfinance have been able to increase their income and hence the standard of living.

Channels of Micro finance

In India microfinance operates through two channels:

- SHG – Bank Linkage Programme (SBLP)
- Micro Finance Institutions (MFIs)

SHG – Bank Linkage Programme

This is the bank-led microfinance channel which was initiated by NABARD in 1992. Under the SHG model the members, usually women in villages are encouraged to form groups of around 10-15. The members contribute their savings in the group periodically and from these savings small loans are provided to the members. In the later period these SHGs are provided with bank loans generally for income generation purpose. The group's members meet periodically when the new savings come in, recovery of past loans are made from the members and also new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular. The SHGs are self-sustaining and once the group becomes stable it starts working on its own with some support from NGO.

Micro Finance Institutions:

Those institutions which have microfinance as their main operation are known as micro finance institutions. A number of organizations with varied size and legal forms offer microfinance service. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee. The reason for existence of separate institutions i.e. MFIs for offering microfinance are as follows:

- High transaction cost – generally micro credits fall below the break-even point of providing loans by banks
- Absence of collaterals – the poor usually are not in a state to offer collaterals to secure the credit
- Loans are generally taken for very short duration periods
- Higher frequency of repayment of instalments and higher rate of Default

Non-Banking Financial Companies (NBFCs), Co-operative societies, Section- 8 companies, Societies and Trusts, all such institutions operating in microfinance sector constitute MFIs and together they account for about 42 percent of the microfinance sector in terms of loan portfolio. The MFI channel is dominated by NBFCs which cover more than 80 percent of the total loan portfolio through the MFI channel.

NABARD ISSUES RELATED TO MICROFINANCE:

Although the SHG-Bank linkage model is well managed in India by NABARD, currently there is no proper regulatory body for the supervision of MFIs. The presence of institutions with a variety of legal forms makes it difficult for the regulation of all such institutions by a single regulatory body in the current Indian legal structure. Though NBFCs, which cover the major part of the outstanding loan portfolio by the microfinance channel, are regulated by Reserve Bank of India, other MFIs like societies, trusts, Section-25 companies and cooperative societies fall outside the purview of RBI's regulation. The acceptance of the Malegam committee recommendations by the RBI is a big step forward in addressing the above concern but again it will cover only a section of the MFIs i.e. NBFCs. The microfinance bill which was introduced in the year 2007 is still pending. The most recent and the strongest step taken by the government, The Micro Finance Institutions (Development and regulation) Bill, 2011 is a major step in the microfinance sector. The proposed bill clarifies all doubts pertaining to regulation of the MFIs by appointing RBI as the sole regulator for all MFIs.

Recommendations:

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.

REFERENCE

1. Basu, Priya. "A Financial System for India's Poor", *Economic and Political Weekly*, Vol. 40, No. 37, pp. 4008-12, 2005. | 2. Beck, Kunt and Patrick. "Access to Financial Services: Measurement, Impact and Policies", *The World Bank Research Observer*, Vol. 24, No. 1, pp.122-33, 2009. | 3. Dev, Mahendra S. "Financial Inclusion: Issues and Challenges", *Economic and Political Weekly*, 2006, Vol. 41, No. 41, pp. 4310-13. | 4. Ellis, Karen. "Is Financial Liberalization enough to promote Financial Inclusion?", *Overseas Development Institute, Working paper*, 2009, pp.82-83. | 5. Frost and Sullivan. "Bringing financial services to the masses: An NCR White Paper on Financial Inclusion", *NCR Corporation*, 2009, pp. 54-61. | 6. [6] Joshi, Deepali Pant, *The Financial Inclusion Imperative and Sustainable Approaches*. Delhi: Foundation Books, 2011, pp.13-19. | 7. Karmakar, K.G. and Mohapatra, N.P. "Emerging Issues in Rural Credit", *The Microfinance Review*, 2009, Vol.1, No. 1, pp.1-17. | 8. Karmakar, K.G. et al. *Towards Financial Inclusion in India*. New Delhi: Sage Publications. 2011. | 9. Khan, R. Harun. "Issues and Challenges in Financial Inclusion: Policies, Partnerships, Processes and Products", *RBI Monthly Bulletin*, 2012, pp.1447-57. |