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Micro-Realities of Microfinance Institutions in India

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ABSTRACT

It is generally believed that microfinance reduces poverty significantly by giving credit to the poor who in turn invests in income generation activities. The poor would thus graduate out of poverty. This exploratory article discusses about the micro finance concepts and its contributions as a creative financial tool for managing inclusive growth. It also enumerate the evolution of microfinance in India, the activities of NABARD and the different linkage models of the Microfinance Institutions. The current setup for regulating the microfinance Instituttions in India and the retrospective effect of the AndhraPradesh crisis is also deeply analysed. The contribution of microfinance for inclusive growth of the country is discussed through the Self-Help groups..The myth that Microfinance as a standalone tool contributes for Capacity Building, Poverty reduction and empowerment of women is tested for its reality. Also the risks involved in micro-lending and the alternative models to mitigate those risks are discussed. It is concluded that by involving alternative models in Micro finance lending practices and through channelized regulations from the centre and through transparent operations, the MFIs should protect the interests of the clients and should help them in getting relieved from their existing debt traps.

KEYWORDS Micro finance, Micro Credit, NABARD, Self-Help groups, NGOs, Percapita Income, Inclusive growth, Joint Liability Groups(JLGs)

Introduction to Microfinance

It is a universally accepted fact that the power of financial services to the customer, particularly low-income households is realized only through the availability of a broad range of services, and not just through small loans or opening bank accounts. Microfinance is one of the financial services offered to rural and poor as a part of the financial inclusion programme.

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.

More broadly, it is a movement whose object is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers.-Those who promote microfinance generally believe that such access will help poor people out of poverty.

Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Although microcredit is one of the aspects of microfinance, conflation of the two terms is endemic in public discourse. Critics often attack microcredit while referring to it indiscriminately as either 'microcredit' or 'microfinance'. Due to the broad range of microfinance services, it is difficult to assess impact, and very few studies have tried to assess its full impact.

Microfinance and Inclusive growth

Indian microfinance has continued growing rapidly towards the main objective of financial inclusion extending outreach to a growing share of poor households and to the approximately 80% of the population, which has yet to be reached directly by the banks. The larger of the two main models, the self Help Group Bank Linkage Programme covered about 14 million poor households in March 2006 and provided indirect access to the banking system to another 14million, including the borderline poor. Although firm estimates are lacking, the other, the Microfinance Institution model, served 7.3 million households, of which 3.2 million were poor. Roughly one out of four Indians live below the poverty line defined by the Government of IndiaMicro finance enables people generate self-employment in animal husbandry, in all kinds of petty trading, in provisions of local transport, sari and carpet weaving and cultivation of leased-in agricultural land.

Microfinance Institutions in India

Microfinance institution is generally defined as an institution that provides financial services to the poor.. MFIs provide microfinance services to those people who are living in poverty and are excluded from the financial system because of their inability to produce guarantees that are required to gain credit from formal financial institutions.

The 10 biggest MFIs in India

Name	Gross Loan Portfolio (US $ crore)	No of active borrowers (lakh)
SHARE	91.7	8.3
Spandana	90	9.7
SKS	61.4	5.1
SKDRDP	52.2	4.4
MFI	50	2.9
AML	39.9	3.9
BASIX	32	2
Bandhan	30	4.5
Cashpor MC	19.8	2
GV	18.4	1.8

Source: IFMR Centre for Microfinance website

Roughly one out of four Indians lives below the poverty line defined by the Government of India. The GoI – poverty line for the urban areas is monthly per capita consumption expenditure of Rs.538.60 for urban areas and Rs.356.35 for rural areas. A 2007 report by the state-run National Commission for Enterprises in the Unorganized Sector (NCEUS) found that 25% of Indians, or 236 million people, lived on less than 20 rupees per day with most working in "informal labour sector with no job or social security, living in abject poverty".

According to the Deputy Governor of RBI, Smt. Usha Thorat, on an All India basis 59% of adult population in the country has bank accounts. In other words 41 % of the population is unbanked. In rural areas the coverage is 39 % against 60 % in urban areas. The unbanked population is higher in the North Eastern and Eastern regions. The extent of exclusion from credit markets is much more, as number of loan accounts constitutes only 14% of adult population. In rural

areas, the coverage is 9.5% against 14% in urban areas. Regional differences are significant with the credit coverage at 25% for the Southern Region and as low as 7,8 and % in North Eastern, Eastern and Central Regions respectively.

Regulating Microfinance Institutions

RBI has seriously attempted to regulate the MFIs and this trigger is evidently due to micro-finance crisis in Andhra Pradesh, following reports about the usurious lending practices combined with coercive recovery procedures adopted by microfinance institutions. Also, if the State Governments start, enacting their own legislations to regulate MFIs, including the one regulated by RBI, there will be a plurality of regulation, leaving scope for regulatory arbitrage. The State Governments' has taken the stance that micro-loans in the State would continue to be regulated as per the State Act. The implications of this multiple regulations are

- There will be dual registration
- The codes of conduct for recovery would be different.
- The provisions for repayment would also differ between the two.

Although RBI has deregulated the interest rates and freed the savings deposit rates, the current directives for NBFC-MFIs go against this stance. Furthermore, a ceiling of 26% rate of interest would make it appear that usurious lending has RBIs blessings. Even at the peak of interest rate cycle in the past, when directed credit was the norm, never was there a norm like 26& for any sector.

The Reserve Bank of India has decided to accept the broad framework of the recommendations of the Malegam Committee for the microfinance industry, but it has modified some of the proposals of the committee.In its policy **announcement** on May 3, 2011, RBI governor D. Subbarao said that all bank loans to microfinance institutions (MFIs), including non-banking financial companies (NBFCs) working as MFIs would be treated as priority sector lending. However, this will depend on whether the prescribed percentage of total assets of such firms are so-called 'qualifying assets' and adhere to 'pricing of interest' guidelines. SA-Dhan, the apex organization of micro-finance institutions (MFIs) and Self-help groups required for moderation of Interest rates charged by MFIs ie., atleast 2-3% decline in the effective interest rates and as a part of Code of Conduct. MFIs would also have to disclose the salaries paid to their CEOs.

MFIs involvement in poverty reduction , Capacity building and Empowerment

In India, several Government – sponsored, highly – subsidised microfinance programmes such as the Integrated Rural Development programme and Differential Rate of Interest have failed to deliver. They are very long on intent and short on delivery models. MFIs have become adept in creating a reality of their own.

Milford Bateman, in his book " Why Doesn't Microfinance Work?" sets out well-reasoned arguments and empirical evidences and demolish the myths of microfinance.

MYTH	REALITY
Microfinance supports income-generating activities	70% of the loans are used for purposes other than income generation
MFIs can be self-sustaining	Of the 10,000 MFIs in the world only 3-4% is financially self-sustaining
Microfinance is what poor need and want	The percentage of poor wanting to run enterprise in preference to wage employment is so meagre
It is not the high interest rates but the availability of micro credit which is a problem for the poor	National Sample Survey had brought out that a large proportion of micro-credit clients are worse off after accessing loans
Higher repayment rates prove that borrowers are succeeding with their expensive micro loans	There is a high disconnect between repayment and development as the poor have fall-back strategies to repay micro loans.

Retrospects of Andhrapradesh MFIs crisis and Malegam Committee Report

Interest Cap

The committee reports that repayment of old debts accounts for about 25% of the new loans taken by Joint Liability groups/SHGs , while another 25% goes for income generation activities. The panel recommended a cap of 24% interest rate plus 1% insurance costs on MFI loans which could still prove too high for the poor to bear.

Repayment frequency and recovery mechanism

The committee suggested that MFIs should be given the freedom to fix the pattern of repayment and thereby increased the interface between borrower and MFI, the nature of which cannot be controlled at the ground level. The measures to ensure transparency and fair treatment of clients by the recovery agents are difficult to enforce as there are over 1,500 MFIs in the country.

Government Intervention

While Government intervention to the extent of clearing the loans may be detrimental to the industry in the long run, it might be a workable solution in the short term, at least till the industry learns to regulate itself. The committee also recommended that no more than two MFIs should lend to a borrower and that a workable mechanism to be developed to check multiple lending.

Creation of Micro-lending NBFCs

The RBI has given its go-ahead to create a separate category of non-banking finance companies that would provide microfinance to low-income groups, a move that should make banks more comfortable lending to microfinance institutions. RBI appointed Malegam committee had recommended forming a special category of NBFCs that would give loans to MFIs. The panel suggested that MFIs must have a minimum net worth of Rs15 crore to qualify as a NBFC – MFI. Minimum entry-level capital requirement for micro finance NBFCs which are involved exclusively in financing SHGs be reduced to Rs. 25 lakhs from Rs. 200 lakhs at present. However, such NBFCs may not be allowed to accept deposits until their capital is raised to Rs. 200 lakhs.

Managing risks in microfinance

Microfinance institutions essentially act as financial intermediaries, bridging the gap between mainstream financial institutions and low-income households for a specific type of credit need that is short-term and unsecured. The concept of risk lies at the heart of any such financial intermediatio



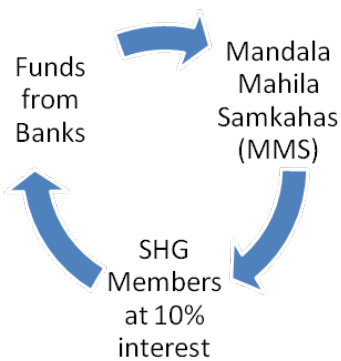
Systematic Risks – Risks due to rainfall failure, impact of political influences, scrutiny and intervention of Government regulations affects the large number of clients and the operations of Microfinance Institutions which can be mitigated with insurance coverage, diversifying across regions and ensuring clarity on regulatory framework**.**

Idiosyncratic Risks- It is internal to an entity and comprises operations and credit risk. In the Joint Liability Group (JLG) model, credit decisions are taken by the group on the basis of its access to private information about each member and hence the dilution of group formation and meeting norms are early warning signs of process deterioration and should trigger concerns about credit quality

Operational Risks- Microfinance is an operations-intensive model and weak processes affect internal control and manifest as fraud and other operational failures. Detailed mapping of the processes and sub-processes will help MFIs identify risks, as also the weak links that pose a greater threat of fraud. A risk-scoring model basing the diverse parameters for each branch will also minimize this risk.
Cash Movement Risk – As all the MFI disbursements and collections are cash-based, the institutions face high risk due to movement of cash. If the cash movement is not tracked and checked against demand and collections, it can result in fraud. Such fraud can be mitigated by MFIs setting cash retention limits for branches, with deviations approved and recorded and reconciling through MIS at branch levels
Interest Rate Volatility – It is one of the key risks the MFIs are facing today. Changes in interest rates at which they borrow impact spreads, especially in the short term. Increase in cost of funds severely squeezes margins, impacting profitability and operational self-sufficiency. Long-term borrowing, with hedging and diversification of funding sources, will enable MFIs to mitigate interest rate risk.

Alternative Models to Micro Lending

The inherent constraints in the present microfinance lending models paves way for the development of alternative models of reaching credit to the poor. The new model ropes in the banks to fund to Mandala Mahila Samkahas (MMS) directly which would, in turn, lend to SHG members at 10% interest. This model would definitely help in reaching the poor at a low cost.



Conclusion

The microfinance sector in India has been growing rapidly in both scale and institutional diversity, making it the largest in the world. The recent developments in the microfinance sector warrant taking a closer look at the accompanying social environment and policy framework. As the sector grows and competition increases, over-indebtedness of clients become a concern. We need to find out the extent and patterns of competition, the extent of multiple borrowing and whether this is bad or not. We need to think of the ways to manage competition so that it affects clients positively. All these issues raise the question of a credit bureau in India as such a bureau could play a vital role in disseminating information. The move of RBI to create NBFC - MFIs is seen as a booster, since the cap on the interest and margin at 26 % and 12% respectively. The new norms on pricing transparency and safeguards against harassment of clients by field staff are some of the important aspects .

Given the inherent conflict between social objectives and profit motives in the MFI industry, it is probably necessary to think of alternative models of reaching credit to the poor.

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