



EXPERIENCE WITH MICROFINANCE IN INDIA

Siddharth Dutt

Abstract

FINANCIAL INCLUSION is concept that defines that the individuals or firms have access to financial services but that does not mean facility of finance at any cost. The term finance inclusion can be understood by 4 factors viz. Access to financial services (in terms of physical proximity and affordability), quality of financial services (products match the needs of customers), usage of financial services (including regularity and frequency of use) and welfare effect of finance services in terms of consumption and productivity. Many Failures with respect to microfinance and other modes of financial inclusion have posed challenge for the governments. The present paper reviews the role and effect of financial inclusion in form of Micro finance in India in last couple of years.



Scholarly Research Journal's is licensed Based on a work at www.srjis.com

INTRODUCTION:

Financial Inclusion For The People Without Any Access To Institutional Support

Recent World Bank report says that South Asia remains one of the world's fastest growing region and among the south Asian countries, India as fast moving economy continues to lead in economic performance. Poverty in the member countries is core issue still presenting challenges for socio-economic development. Indian rural development report 2013-14 indicated that 16.84% of rural population in India is poorest of poor. Compared to world's extremely poor population of 766 million, around 33% live in south Asia. Urban poverty is also growing with fast rate because rural to urban migration has been permanent phenomena in developing nation. It has become important to help rural poor, mostly involved in primary sector of economy, in attaining sustainable economic model of development and thus uplifting the families above poverty line.

Census 2011 data shows that around 46% of rural households and 25% of urban households in country do not have access to proper banking facilities. World Bank survey (2012) shows that overall only 35% of adults in India had access to formal banking and only 8% were benefitted by credit facilities offered by formal institutions. Government tries to expand the banking and credit facilities throughout the length and breadth of country by introducing new

branches of cooperative banks, rural banks and public sector banks. The most important steps taken by government either directly or indirectly are:

- (1) making mandatory for banks to achieve priority sector lending targets
- (2) facilitation of environment for formation of self-help groups (SHG) by help of NGOs
- (3) Introduction of concept of Business correspondents (appointed by Banks) for providing home banking services to poor rural masses.
- (4) Opening up of bank accounts of poor people under prime minister's Jan Dhan Yojna (PMJDY).
- (5) Expansion of micro-finance throughout the country

MICROFINANCE IN INDIA (CONSICE DETAIL)

MFIs issue small loans and credits to borrowers from low-income group who have been suffering from financial exclusion because they are either denied or don't have access to formal institutional system of finance and banking. The concept of microcredit and microfinance was the brain child of Dr. Mhod. Yunus (noble laureate) who recognised that small credits can bring some permanent but positive changes in economic conditions of poor. He started with rural women and provided small credits to enable them start some new trade or business. For this, He founded Grameen Bank in 1976, a non-profit organisation and source of microfinance to rural people, mostly women, in Bangladesh. Grameen bank believed that with respect to men, women from poor households are more intelligent to spend and save money for future of their families.

In India, Emergence of microfinance institutions is traced back to late 1980s. Basic but most important fundamental of this noble concept was to focus on rural people who have no collateral to get loans from formal banking and finance sector and don't have any permanent sources of income. Microfinance also includes group lending, imparting education & training, health care and other social services. indian microfinance sector involves combined form of microfinance that include Grameen model and other group models like joint liability group model, franchisee model and self-help group model. However the self-help group model is most popular in Indian scenario and the Self-Help Group (SHG)- Bank linkage programme remained dominant in microfinance. The model was started by NABARD in 1992. Similar schemes related to micro finance/ credit was launched by SIDBI in 1994 and fresh microcredit foundation by SIDBI was put into action in 1998.

MICROFINANCE POST-2010

One important fact existed (2009-2010) that there had been very high concentration of microfinance business in state of Andhra Pradesh and it had above one third of gross microfinance clientele in country. All the credit goes to Efforts of state's chief ministers -shri Y S R Reddy (2004- 2009) and shri Chandrababu Naidu (1995-2004 and 2014 - till date). Both the previous and incumbent chief ministers believed in power of microfinance environment and pinned their hopes on it for eradication of poverty and rural sector suicides. But the liberal credit-offers to farmers without quantifying repayment capabilities turned productive credits into pile of burden for the borrowers.

After Andhra Pradesh- MFI crisis in October 2010, Y.H. Melegam- committee, formed by RBI (October 2010), recommended regulation of microfinance sector by Self-regulatory organization framework. Formulation and compliance of rules related to code of conduct was to be exercised by the SRO. Complaints, dispute resolution and grievance redressal system was put under preview of SRO.

Sa-Dhan is association of institutions involved in business of microfinance also termed as MFIs. In February 2015, Reserve bank of India has given recognition and awarded status of self-regulatory organization (SRO) to the Sa-Dhan, empowering it to keep eye on the MFIs and regulate the business as per norms and rules. Earlier in February 2014, MFIN (micro finance institution network) was the first association to be recognised by RBI as SRO in February 2014. All non-banking financial companies (NBFCs) are part of MFIN-association. Bharat Microfinance report (Sa-Dhan) was released for FY 2015-16. The next report is due in September 2017. Report gave important data about health of microfinance in India. There are 33 states and UTs where microfinance environment has been set up in total 588 districts and 39 million clients have been benefitted by microfinance involving around Rs 17000 crore. Bank- correspondent mode of business accounts for about Rs 8000 crores. Little above 93% of total loan money was utilised in income generation purposes. This is very optimistic data with respect to large country like India. Southern Indian states witnessed the greatest Penetration of microfinance business and by 2009 Andhra Pradesh was leading in number of clients that sum up to 35% of whole country. Southern states continue to lead in number of loans and outstanding loans till present. Eastern states come to 2nd position. Most important finding is that around 97% of clientele in country are women. By 2015-16, Microfinance Penetration (outreach) increased by 8% and outstanding amount of loan grew by 31% over the previous year of 2014-15.

Microfinance business (India) can be divided into NGO-Operated managing 15% share of clients and Non-banking finance companies (NBFC) operated having 85% shares of clients. Financial cost (expenses) is most important expense and it includes:

- (1) Net interest cost that is generally above 80%
- (2) Net non-interest costs of fund sourcing, that is generally above 10%
- (3) Cash holding cost/ idle fund cost that is around 4%
- (4) Taxes incur smaller cost (around 2% to 4%)

Financial expenditures remained around 53% of total cost incurred by MFIs. Administrative and personal expenditure was around 24% each. Operating expense ratio (OER) has come down with time because of increased number of clientele. OER generally remained between 10.5% for smaller portfolio companies to 7.5% for bigger portfolio companies dealing above Rs 500 crores. Capital Adequacy Ratio of all MFIs fall in desirable standard of 15%.

The gross NPA of Self Help Group loans is still matter of concern. In 2016, it was 6.4%, around 0.6% lesser from previous year. This is still big figure to manage. There has been growth of SHGs linked to bank loan and credits after 2010-11. Bank Correspondent model has become increasingly accepted by MFIs in last couple of years.

Problems creeping into microfinance sector

Non profiteering objective of microfinance has lost in clouds of time. Success story of microfinance in Bangladesh (Grameen Bank) resulted creation of illusion among the profiteers that same can be repeated everywhere and it can be used to make profits. By November 2010, India became the name associated with fastest growth of microfinance companies. There were around 10 lakh people getting Micro-credits in 2003 which inflated to 27 million in number by 2009. Few Capitalists like vikram Akola and Vinod khosla were pioneer in reaping the harvest from noble institute of microfinance. This makes the whole scenario dirty. Few districts, where potential had been high were intruded by as many as ten microcredit companies to offer finance.

The basic structure of microfinance model (Grameen Bank) consists of formation of groups of size 5 to 10 members. Group manages the social collateral against the credit. Group provide social support base for its members. Peer monitoring results better enforcement mechanism (J. Stiglitz, 1990). But, as in many parts of world, Microfinance in India was transformed to profit earning business and the genuine practices were ignored. Group lending and social services were shunned by many micro-creditors and the newer loans were easily issued without collateral to same borrower. This was misused by borrowers, for example,

Newer loan used to finance interest payment of older loan or utilisation of loan money in unproductive use.

Grameen project (Bangladesh) also pioneered the new system that if loan remains unpaid in given interval of time, it is changed into type of flexible loan where borrowers can repay reduced amounts over extended time in case they are hit by some disaster. These remains absent in modern day microfinance system operated by private players. They are bound to timely repayment and used coercive methods towards borrower. Loan officers started harassing borrowers resulting into spate of suicides. Problems took form of crisis in state of Andhra Pradesh because liberal credit schemes without calculating repayment capabilities and higher aspirations of farmers mixed up. Multiple loans to single borrower were fuelled by business interest and profits. Defaulters were intimidated and many took services of moneylenders who charged exorbitant rates. Suicides were the result of this approach and government remained mute and dumb till the water flowed over the head. In haste, the state government passed a law on October 2010. Microcredits were stopped and business of microfinance companies came to halt. Interest rates were capped and similar decisions were taken to protect farmers

Conclusion

Microfinance and microcredit have emerged as modern way of financial inclusion for the poor and marginalised people without any access to institutionalised facilities. Banks have important role in disbursing the credits but they work on professional lines of business where loans are for people who have proven abilities to repay or for those who are involved in some serious economic activity capable of generating profits. The root problem exists that how a poor can get small loan to start some productive entrepreneurship, business or farm related activities. There are Inadequacies in access to formal finance through systematic machinery have led to the growth of microfinance in different countries including India. There are inadequacies in socio-economic set up that 'poverty – illiteracy- unemployment –poverty' become prominent cycle that is hard to break in most of the cases.

There are needs to protect the small and marginal farmers' household from the huge interest that microfinance companies seek against the credits. High to very high interest rates charged by profiteering MFIs ranges from 20% to 35%.

It is irony of our system that on one hand, institutional banks charge 11% to 18% interest rates from their customers but on another the poor men from lowest strata of society, who

neither are capable by themselves nor have good income-resources, have to pay exorbitant interest on credits.

Loans are meant for people who have at least some potential to utilise it in productive way. Not all poor are entitled for loan. This was ignored because companies only aimed to expand number of loans as it is seen directly as potential factor of increasing profits. Credit history of borrowers was ignored and multiple loans were sanctioned to same person who still had not repaid the first loan. The situation worsens for e.g. in case of south Indian states where the crops failure of the households resulted piling up of unpaid loans. Arvind Panagariya, Professor of Economics at Columbia University once said that microfinance has been imposed to Indian poor and vulnerable, without calculating credit worthiness of borrowers. Also the recovery methods were coercive. He added that people are overwhelmed with hopes that microfinance is most successful income-generating mechanism in India.

The MFI-created crisis (2008-2010) taught us that private microcredit business should be highly regulated and well managed by them. Privatisation is not just a word but it is a concept which believes in managing funds, manpower and machine to extract the profits with some minimum growth. Uncontrolled private participation in case where beneficiaries are ignorant, poor illiterate and most vulnerable in society surely results socio-economic hazards.

RBI decision (2000) of notifying inclusion of microfinance sector into priority sector lending by banks was highly appreciated. This will ensure that necessary funds for business of microfinance are released by the banks in substantial amount. Microfinance institutes can now have access to banks for necessary funds. It was very disturbing that many MFIs legally did not come under preview of RBI and RBI reacted by frowning upon MFIs for using wrong methods of raising funds and deposits. At last the microfinance bill was passed by parliament in May -2016. The bill have rules and regulations concerning licensing, regulating and supervision of companies. This is done too late and late actions at national level on sensitive issues are sign of incompetency on part of legislature. Why government wait for mishappening or hazards to occur after which the eyes get open.

At last it is important to understand that loans and credits easily convert into non-performing assets it basic things are missing. Education and government support are most important. Basic training and supportive infrastructure should be made mandatory part of credit and finance services. Insurance should be made to cover all who borrows or get financed. The other important factor is that productive-credits should never be misused as is prevalent in India. Loan for crops have been misused in family celebrations like weddings or in making

house etc. group pressure is important in checking the misuse of credits and this has been evident from Grameen Bank model of Bangladesh.

Bank –linked self-help group (SHG) model has been very successful Indian innovative concept in microfinance. Self-employed women’s association has been doing well in bringing positive changes in life of women. India need direct linking of banks to credit and finance. Rules and regulation are important and government cannot escape from its responsibility or avoid its liabilities toward the section of country that include poor, small and marginal farmers, casual labourers and other unemployed people who don’t have much hope of support.

References:

- The-Bharat-Microfinance-Report-2016.pdf*. retrieved from: www.sadhan.net/Resources/BMR2015flyer.pdf
- Assocham India. (July 2016). *Evolving landscape of microfinance institutions in India*. Retrieved from: [http://www.ey.com/Publication/vwLUAssets/ey-evolving-landscape-of-microfinance-institutions-in-india/\\$FILE/ey-evolving-landscape-of-microfinance-institutions-in-india.pdf](http://www.ey.com/Publication/vwLUAssets/ey-evolving-landscape-of-microfinance-institutions-in-india/$FILE/ey-evolving-landscape-of-microfinance-institutions-in-india.pdf)
- Editor. (2013). *Still an elusive goal: measuring the impact and success of microfinance*. Retrieved from <http://knowledge.wharton.upenn.edu/article/still-an-elusive-goal-measuring-the-impact-and-success-of-microfinance> (24.04.2013)
- Ponomarenko, L. (2011). *A Lesson to Be Learned from India's Failing Microfinance.. Alternatives international journal (e-copy)*. Retrieved from: <http://www.alterinter.org/spip.php?article3582> (30.06.2011)
- Aguera.p. (senior financial sector specialist, World Bank) (2015). *Finance for All. ECCAS Regional Conference, Brazzaville, Congo (March 23, 2015)*. Retrieved from: <https://www.imf.org/external/np/seminars/eng/2015/brazzaville/pdf/AgueraENG.pdf>
- Roy. S. (2016). *India’s microfinance industry clocked 60% growth in fiscal 2016: Report*. Retrieved from: <http://www.livemint.com/Industry/4Zb0zp5yOh0toqEdBFz4jL/Indias-microfinance-industry-clocked-60-growth-in-fiscal-2.html>
- Dhar. P. (2016). *Microfinance Penetration in India: a State Wise Analysis*. Retrieved from: <http://ijirssc.in/pdf/1483192772.pdf>
- Bandyopadhyay. T. (2015). *Indian microfinance institutions have just busted a myth*. (19.10.2015). Retrieved from: <http://www.livemint.com/Opinion/vKWsSxGepyqdNP4hNTrw7H/Indian-microfinance-institutions-have-just-busted-a-myth.html>
- Ashwin. H. (2016). *Microfinance Bill passed in Parliament*. Retrieved from: <http://www.ft.lk/article/540283/Microfinance-Bill-passed-in-Parliament> (28.06.2017)