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## **Micro-Finance: A Brief Description**

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### **INTRODUCTION:**

During the early 1980's Indonesia emerged with an innovative technique of linking informal and formal financial institutions with financial self-help groups to touch the hitherto neglected groups example small traders, tiny traders like milk, vegetable, fruit sellers etc. workers in non-farm sectors in rural areas etc. The technique gradually transformed into micro-finance. Thus, micro-finance is a recently developed financial service with a novel idea of filling the gaps in the economy. This is an experiment conducted to break the vicious circle of low income, no savings, no investment etc. In long years of banking history, banks could not reach certain categories of group. In agricultural countries like India, cheap, adequate and timely finance is a greater contributor for active functioning of different sectors. But the most important economic problem is scarcity of capital because the income and saving capacity of surplus units is extremely low.

### **MICROFINANCE DEFINITION:**

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*".

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

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### **Who are the clients of micro finance?**

The typical micro finance clients are low-income persons that do not have access to formal financial institutions. Micro finance clients are typically self-employed, often household-based entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade. In urban areas, micro finance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc. Micro finance clients are poor and vulnerable non-poor who have a relatively unstable source of income.

Access to conventional formal financial institutions, for many reasons, is inversely related to income: the poorer you are the less likely that you have access. On the other hand, the chances are that, the poorer you are, the more expensive or onerous informal financial arrangements. Moreover, informal arrangements may not suitably meet certain financial service needs or may exclude you anyway. Individuals in this excluded and under-served market segment are the clients of micro finance.

As we broaden the notion of the types of services micro finance encompasses, the potential market of micro finance clients also expands. It depends on local conditions and political climate, activeness of cooperatives, SHG & NGOs and support mechanism. For instance, micro credit might have a far more limited market scope than say a more diversified range of financial services, which includes various types of savings products, payment and remittance services, and various insurance products. For example, many very poor farmers may not really wish to borrow, but rather, would like a safer place to save the proceeds from their harvest as these are consumed over several months by the requirements of daily living. Central government in India has established a strong & extensive link between NABARD (National Bank for Agriculture & Rural Development), State Cooperative Bank, District Cooperative Banks, Primary Agriculture & Marketing Societies at national, state, district and village level.

### **THE NEED IN INDIA**

India is said to be the home of one third of the world's poor; official estimates range from 26 to 50 percent of the more than one billion population.

-About 87 percent of the poorest households do not have access to credit.

-The demand for microcredit has been estimated at up to \$30 billion; the supply is less than \$2.2 billion combined by all involved in the sector.

Microfinance has been present in India in one form or another since the 1970s and is now widely accepted as an effective poverty alleviation strategy. Over the last five years, the microfinance industry has achieved significant growth in part due to the participation of commercial banks. Despite this growth, the poverty situation in India continues to be challenging.

### **ACTIVITIES IN MICROFINANCE**

**Microcredit:** It is a small amount of money loaned to a client by a bank or other institution. Microcredit can be offered, often without collateral, to an individual or through group lending.

**Micro savings:** These are deposit services that allow one to save small amounts of money for future use. Often without minimum balance requirements, these savings accounts allow households to save in order to meet unexpected expenses and plan for future expenses.

**Micro insurance:** It is a system by which people, businesses and other organizations make a payment to share risk. Access to insurance enables entrepreneurs to concentrate more on developing their businesses while mitigating other risks affecting property, health or the ability to work.

**Remittances:** These are transfer of funds from people in one place to people in another, usually across borders to family and friends. Compared with other sources of capital that can fluctuate depending on the political or economic climate, remittances are a relatively steady source of funds.

### **LEGAL REGULATIONS:**

Banks in India are regulated and supervised by the Reserve Bank of India (RBI) under the RBI Act of 1934, Banking Regulation Act, Regional Rural Banks Act, and the Cooperative Societies Acts of the respective state governments for cooperative banks. NBFCs are registered under the Companies Act, 1956 and are governed under the RBI Act. There is no specific law catering to NGOs although they can be registered under the Societies

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Registration Act, 1860, the Indian Trust Act, 1882, or the relevant state acts. There has been a strong reliance on self-regulation for NGO MFIs and as this applies to NGO MFIs mobilizing deposits from clients who also borrow. This tendency is a concern due to enforcement problems that tend to arise with self-regulatory organizations. In January 2000, the RBI essentially created a new legal form for providing microfinance services for NBFCs registered under the Companies Act so that they are not subject to any capital or liquidity requirements if they do not go into the deposit taking business. Absence of liquidity requirements is concern to the safety of the sector.

#### **PRESENT SCENARIO OF INDIA:**

India falls under low income class according to World Bank. It is second populated country in the world and around 70 % of its population lives in rural area. 60% of people depend on agriculture, as a result there is chronic underemployment and per capita income is only Rs.3262. This is not enough to provide food to more than one individual. The obvious result is abject poverty, low rate of education, low sex ratio, and exploitation. The major factor account for high incidence of rural poverty is the low asset base. According to Reserve Bank of India, about 51 % of people house possess only 10% of the total asset of India .This has resulted low production capacity both in agriculture (which contribute around 22-25% of GDP) and Manufacturing sector. Rural people have very low access to institutionalized credit (from commercial bank).

#### **MICROFINANCE SOCIAL ASPECTS:**

Micro financing institutions significantly contributed to gender equality and women's empowerment as well as poor development and civil society strengthening. Contribution to women's ability to earn an income led to their economic empowerment, increased well being of women and their families and wider social and political empowerment .Microfinance programs targeting women became a major plank of poverty alleviation and gender strategies in the 1990s. Increasing evidence of the centrality of gender equality to poverty reduction and women's higher credit repayment rates led to a general consensus on the desirability of targeting women.

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**ROLE, FUNCTIONS AND WORKING MECHANISM OF FINANCIAL INSTITUTIONS:**

**1. ICICI Bank :**

ICICI's microfinance portfolio has been increasing at an impressive speed. From 10,000 microfinance clients in 2001, ICICI Bank is now (2009) lending to 1.8 million clients through its partner microfinance institutions, ICICI Bank drew up aggressive plans to penetrate rural areas through its SHG program. However, rather than spending time in developing rural infrastructure of its own, in 2000, ICICI Bank announced merger of Bank of Madura (BoM), which had significant presence in the rural areas of South India, especially Tamil Nadu, with a customer base of 1.9 million and 87 branches.

**2. Bandhan (Ranked 2<sup>nd</sup> by Forbes Magazine in December 2007):**

Bandhan is working towards the twin objective of poverty alleviation and women empowerment. It started as a Capacity Building Institution (CBI) in November 2000 under the leadership of Mr. Chandra Shekhar Ghosh. During such time, it was giving capacity building support to local microfinance institutions working in West Bengal.

**3. Grameen Bank :**

The Grameen Model which was pioneered by Prof Muhammed Yunus of Grameen Bank is perhaps the most well known, admired and practised model in the world. The model involves the following elements. Homogeneous affinity group of five:

- Eight groups form a Centre
- Centre meets every week
- Regular savings by all members
- Loan proposals approved at Centre meeting
- Loan disbursed directly to individuals

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All loans repaid in 50 instalments .The greatness of the Grameen model is in the simplicity of design of products and delivery. The process of delivery is scalable and the model could be replicated widely.

#### **4.SKS Microfinance :**

Its model is based on 3 principles-

**~Adopt a profit-oriented approach in order to access commercial capital-** Starting with the pitch that there is a high entrepreneurial spirit amongst the poor to raise the funds, SKS converted itself to for-profit status as soon as it got break even and got philanthropist Ravi Reddy to be a founding investor. Later, it was able to attract multimillion dollar lines of credit from Citibank, ABN Amro, and others.

**~Standardize products, training, and other processes in order to boost capacity-** They collect standard repayments in round numbers of 25 or 30 rupees. Internally, they have factory style training models. They enroll about 500 loan officers every month.

**~Use Technology to reduce costs and limit errors-** The system is also internet enabled. Given that electricity is unreliable in many areas they have installed car batteries or gas powered generators as back-ups in many areas.

### **MARKETING OF MICROFINANCE PRODUCTS**

#### **1. Contract Farming and Credit Bundling:**

Banks and financial institutions have been partners in contract farming schemes, set up to enhance credit. Basically, this is a doable model. Under such an arrangement, crop loans can be extended under tie-up arrangements with corporate for production of high quality produce with stable marketing arrangements provided – and only, provided – the price setting mechanism for the farmer is appropriate and fair.

#### **2. Agri Service Centre – Rabo India:**

Rabo India Finance Pvt Ltd. has established agri-service centres in rural areas in cooperation with a number of agri-input and farm services companies. The services provided are similar to those in contract farming, but with additional flexibility and a wider range of products including inventory finance. Besides providing storage facilities, each centre rents out farm machinery, provides agricultural inputs and

information to farmers, arranges credit, sells other services and provides a forum for farmers to market their products.

**3. Non Traditional Markets:**

Similarly, Mother Dairy Foods Processing, a wholly owned subsidiary of National Dairy Development Board (NDDB) has established auction markets for horticulture producers in Bangalore. The operations and maintenance of the market is done by NDDB. The project, with an outlay of Rs.15 lakh, covers 200 horticultural farmers associations with 50,000 grower members for wholesale marketing. Their produce is planned with production and supply assurance and provides both growers and buyers a common platform to negotiate better rates.

**4. Apni Mandi:**

Another innovation is that of The Punjab Mandi Board, which has experimented with a 'farmers' market' to provide small farmers located in proximity to urban areas, direct access to consumers by elimination of middlemen. This experiment known as "Apni Mandi" belongs to both farmers and consumers, who mutually help each other. Under this arrangement a sum of Rs. 5.2 lakh is spent for providing plastic crates to 1000 farmers. Each farmer gets 5 crates at a subsidized rate. At the mandi site, the Board provides basic infrastructure facilities. At the farm level, extension services of different agencies are pooled in. These include inputs subsidies, better quality seeds and loans from Banks. Apni Mandi scheme provides self-employment to producers and has eliminated social inhibitions among them regarding the retail sale of their produce.

**CONCLUSION:**

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. A large variety of actors provide microfinance in India, using a range of microfinance delivery methods. Since the ICICI Bank in India, various sectors 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.

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