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ROLE OF MICROFINANCE IN CREDIT SUPPORT TO BPL SEGMENTS

Pratibha Kumari
B.Com, M.Com
Research Scholar , L.N. Mithila University, Darbhanga.

ABSTRACT

Micro finance institutions play a significant role in ensuring financial inclusion. With respect to the operations of MFIs, one issue relates to the rate of interest. It is recognised that the transaction costs for delivering credit to very small borrowers are high. Also to the extent to which various advisory services are provided. The cost further goes up. It is necessary for MFIs to separate the pure interest costs from other costs which are charged to the borrowers because of the additional services provided. On the whole, they need to be transparent about what they charge. Overall it is necessary to ensure that the burden on the borrower is not such as to make him default. Taking a holistic view, it is necessary for micro finance institutions to keep the overall cost to the borrowers maintained at a level that is consistent with the repaying capacity of the borrowers.

KEY WORDS: Commercial Banks, Financial Inclusion, Micro finance, SHGs.

INTRODUCTION

Nobel laureate Muhammad Yunus has ignited a social business wave through his book 'Building Social Business'. After launching Grameen Bank, which offer microcredit to poor women in particular, and profitable social business like Grameen Danone Foods to produce fortified yogurt for malnourished children, Grameen-Veolia Water to treat contaminants like arsenic in drinking water, Grameen Intel to offer online solutions in healthcare and agriculture, and BASF Grameen to produce chemically-treated mosquitto repellent nets to protect people from malaria, he has been working overtime to add other building blocks like social investment funds and social stock exchanges to complete his vision of a global social business ecosystem. In the process, he has spread the Grameen footprint from Bangladesh to America, Europe and Africa.

NATURE OF INCLUSION

Financial inclusion denotes delivery of credit and other financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. It will be wrong to classify all those who are not borrowing from the organised financial system as excluded. What is relevant is that those who want credit should not be denied the same provided they are bankable. The objective of financial inclusion is to extend the scope of activities of the organised financial system to include within its ambit people with low incomes. Through graduated credit, attempts must be to lift the poor from one level to another so that they come out of poverty.

EXTENT OF EXCLUSION

NSSO data reveal that 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Further, despite the vast net-work of bank branches, only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). Apart from the fact that exclusion in general is large, it also varies widely across regions, social groups and asset holdings. The poorer the group, the greater is the exclusion.

INSTITUTIONAL CHANGES

The question that is before us is how to extend the scope of activities of the organised financial system to include low income groups. The institutions which currently provide financial services in the rural areas include branches of commercial banks, regional rural banks, cooperative societies and microfinance institutions. What is required now is finding ways and means to effect improvements within the existing formal credit delivery mechanism and evolve new models for extending outreach. In a broad sense, we need to address issues on the supply side as well as demand side. The financially excluded sections require products which are customised to meet their needs. Financial exclusion is also caused by demand side issues. Unless steps are taken on the demand side, that is in the "real sector", mere supply side solutions from the financial sector will not work. Credit is necessary for this, but not sufficient. Credit has to be an integral part of an overall programme aimed at improving the productivity and income of small farmers and other poor households. Putting in place an appropriate credit delivery system to meet the needs of marginal and sub-marginal farmers must go hand in hand with efforts to improve the productivity of such farm households. Credit must be linked to production.

COMMERCIAL BANKS

There are 33,500 commercial bank branches in rural and semi-urban centres in the country. The critical question is how to make these rural branches more effective in terms of delivering credit to small and the very small borrowers. For this (i) rural branches of banks have to become farmer-friendly, (ii) they should also advice borrowers on matters relating to agriculture and allied activities, (iii) commercial banks have to open branches in districts where the population per branch is much higher than the national average (RBI identified 139 districts in 15 states as inadequately served by the banking system), (iv) loan granting procedures have to be simplified, through enabling legislation, and (v) the SHG bank linkage scheme has to be strengthened.

The number of self- help groups that had outstanding loans from the banking system is close 4.5 million. Outstanding loans now exceeds Rs 25,000 crore. The financial inclusion attained through SHGs is sustainable and scalable. A distinctive feature of the SHG-bank linkage programme has been the high recovery rate, even though there is some concern on that score in recent period. However, the regional imbalance in the spread of SHGs needs to be corrected.

SHGs also need to graduate from mere providers of credit for non-productive purposes to promoting micro enterprises. According to a recent report, pure consumption accounted for 50% of the loans. There has to be a shift towards income generating activities.

There is no need to provide any interest rate subsidy to SHGs. Banks do provide them credit at reasonable rates of interest. The financial support of the state governments in this regard could be better directed towards building capacities in the self-help groups and providing technology support and marketing facilities.

There are other quality issues which have arisen in the wake of the sharp quantitative expansion. These need to be addressed. Some critical issues relate to the deterioration in the repayment ethics and the continuing small size of the average loan. Data that are now available indicate that roughly 2.9% of the total loans outstanding constitute default loans. Commercial banks reported an NPA level of 2.1%, RRBs 4.5% and cooperative banks 4.8% for the year ended March 2008. The programme which had traditionally enjoyed recoveries close to 98% for more than a decade seems to have suffered in the surrounding climate of waiver of farm sector loans.

The other issue relates to the average size of the loan. The low average size of the loan is a factor that prevents some members of the SHGs from taking up enterprise activities. The average size of loans disbursed range from Rs 37,000 in the case of cooperative banks to Rs 86,000 in the case of RRBs. Cooperative banks have continued to disburse smaller loans. While in one sense small loans are reflective of the capability of the system to reach out to small borrowers, it also indicates a certain degree of risk aversion by the organised financial system. The organised financial system needs to address both the issues of meeting the requirements of the small borrowers and increasing the size of the average loan.

Federations of SHGs at village and taluka levels have certain advantages. However, the disadvantage is that banks may lose their direct contact with SGHs. Perhaps, the best course of action would be to make the federations act as facilitators rather than as financial intermediaries. Federation, if they emerge voluntarily from amongst SHGs must be encouraged.

The sixth issue is that, even though SHG-bank linkage has emerged as an effective credit delivery channel to the poor clients, there are segments within the poor who are left out such as share croppers/oral lessees/tenant farmers, whose loan requirements are much larger but who have no collaterals to fit into the traditional financing approaches of the banking system. To service such clients, Joint Liability Groups (JLGs), an upgradation of SHG mode, could be an effective way.

Finally, the business facilitator and correspondent model needs to be effectively implemented. Rules, at present, permit not only institutions but also several categories of individuals to function as business correspondents. This list can be further expanded. The recent announcement of the RBI to allow the corporates with a wide network of retail outlets to become business correspondents is a welcome step.

ROLE OF TECHNOLOGY

In the task of making banking services available to everyone, technology has an important role to play. The required outreach into interiors with low operational costs is only possible with the use of technology. Technology has to be leveraged to create channels beyond branch network to reach the unbanked. In short, technology has to enable the branch to go to the customer instead of the other way round. The essential ingredients of all the models of technology support under consideration include:
(i) The issue of a smart card to the village client; (ii) a hand-held terminal with the business correspondent; and (iii) a central processor unit (CPU) linking the smart cards and BC terminals with the banks.

MICRO FINANCE INSTITUTIONS

Several concerns regarding the functioning of the micro finance institutions particularly the non-bank finance companies have come to the surface in recent months. The concerns relate to the coercive methods adopted for recovery, multiple lending and ever greening of loans. It is also reported that a significant part of the loans granted was for consumption and not for income earning activities. This is contrary to the principle of self-help. Multiple lending without examining the repaying capacity of the borrowers can only worsen the situation at some point. MFIs, even with their commercial orientation, must rectify these mistakes. Otherwise, they will also become commercially unviable. The micro finance movement must have as its ultimate goal the desire to help the poor and enable them to come out of poverty. Providing credit for productive purposes at reasonable rates of interest must be the goal. The business model of MFIs has to undergo a change.

Looking at the picture as a whole, two initiatives that will bring about a significant surge forward of the micro finance sector will be the growth of the bank-SHG linkage programme and the expansion of the programme of business correspondents. The two will constitute the main pillars of the future development of bank related micro finance, even as other forms of micro finance institutions will continue to grow. The goal of making a significant progress towards financial inclusion seems attainable. In fact providing access to finance is a form of empowerment of the vulnerable groups. Financial inclusion is no longer an option but a compulsion.

Criteria for linking to a bank and providing loan to the members

SHGs must save for at least six months before they can be linked to a bank credit or provide loans to its members. The rate of interest in lending to any group member and the amount to be given should be decided by the members of the group themselves. The rules and regulations for lending money should be decided by the group only. Whether loan should be given to a member or not also depend upon the consensus of the group. Soon after an SHG is formed and one or two meetings held where the savings are collected, a savings bank account can be opened in the name of the SHG. According to a handbook issued by NABARD, following steps should be taken before opening a saving bank account.

Resolution of SHG:

The SHG has to pass a resolution in the group's meeting signed by all members, indicating their decision to open SB A/C with a bank. This resolution should be filed with the bank.

Authorization from SHG:

The SHG should authorise at least three members, any two of whom, to jointly operate upon their account. The resolution along with the filled in application form duly introduced by the promoter may be filed with the bank branch.

Copy of the rules and regulations of SHG:

This is not mandatory if the group has not formulated any such rules or regulations. Loans can be sanctioned even without this.

A savings bank account passbook may be issued to the SHG. This should be in the name of the SHG and not in the name of any individual/s.

A Roadmap of SHG till now

The small beginning of linking only 500 SHGs to banks in 1992, has grown to over 0.5 million SHGs by March 2002 and further to 8 million SHGs by March 2012 according to a report by NABARD. In southern states, almost 100 per cent of the SHGs are linked to banks in the pilot stage, while the total number of SHGs linked in southern states shrank to 46 per cent by March 2012. On the other hand, the share of eastern States (especially, West Bengal, Odisha, Bihar) shot up to over 20 per cent as per NABARD data of micro financing. This means that SHGs are being self-reliant in southern states and are in a mature phase, while it is still gaining its ground in eastern states. But the day is not far away when it will stand with strength in the eastern states too.

The SHGs can also be community platforms from which women become active in village affairs, stand for local election or take action to address social or community issues like the abuse of women, alcohol, the dowry system, schools, water supply and so on.

Partners in financial inclusion

MICROFINANCE's contribution to financial inclusion rivals, if not exceeds, that of the rural banking system. With the phenomenal growth recorded by microfinance in recent years-62% per annum in terms of the number of unique clients and 88% per annum in terms of portfolio over the past five years-and around 27 million borrower accounts, India now has the largest microfinance industry in the world.

The high growth rate of microfinance has been fuelled by commercial bank funding which inherently gravitates towards for-profit institutional structures. Thus, there is a continued India-wide trend towards the transformation of MFIs into for-profit nonbank finance companies (NBFCs) so that over 50% of the 66 MFIs now consist of such institutions. At the regional level, the south continues to dominate the sector in the concentration of MFIs. The rush to be regulated (as NBFCs) along with the push for growth has become the dominant characteristics of Indian microfinance.

With 27 million borrower accounts served by MFIs by March 2010, Indian microfinance represents a significant sub-sector of the financial system. It exceeds the number of borrower accounts served by the Regional Rural Banks (RRBs) by 50% and represents 40% of the total number of micro-borrower accounts in the entire Indian financial system. There are around 18 million microfinance clients in India. This represents 8.2% of the total number of 220 million families in the country and 13.6% of the 60% population that is thought to be financially excluded. In theory this holds out the tantalising prospect of a market with tremendous growth prospects; a perception that is the root of some of the ills that currently bedevil Indian microfinance.

The end-March 2010 portfolio of the microfinance sector is 0.64% of the total credit outstanding of the banking system, 28% of the credit outstanding of RRBs and nearly 20% of the credit outstanding of the district cooperative banks (DCCBs). At its current rate of growth the microfinance sector will match the RRBs and exceed the total portfolio in micro-accounts of all scheduled commercial banks within the next three years.

Concentration is high. The largest of 10 MFIs account for 77% of all borrower accounts in the microfinance sector and 79% of the portfolio. MFIs registered as for-profit NBFCs service 84% of all borrower accounts and manage 88% of the portfolio. In March 2010 there were 25 MFIs classified by the RBI as 'systemically important', with portfolio in excess of Rs 100 crore, though only two had been licensed for deposit taking.

At constant prices, average loan balances with MFIs were more or less flat for a number of years, until March 2007. Since then, the value has increased by 12% over March 2002 as MFIs have entered a high growth phase.

Since most MFIs cannot legally accept thrift deposits so they are limited to small amounts of client deposits as cast security. The average contribution of deposits ranges from 4-8% of loans outstanding compared to 30-40% in Bangladesh and Indonesia. Growth in deposit services would not only provide an additional source of funds to MFIs but it would also help to round out their relationship with clients and reduce the risk of coercive collection behaviour by MFI staff.

Introspection on issues of multiple lending, the quality of internal control system and steps to improve portfolio management are certainly called for. The implications of high growth rates for the issues that have emerged are obvious: unbridled growth leads to untrained staff, an increase in multiple lending, deterioration in control systems and the potential for malpractices in loan collection.

The financing pattern of microfinance in India has increasingly focused debt through the past decade. Starting with a trickle of funds from Sidbi, the flow of funds from commercial banks to MFIs become a virtual flood by the end of the 2000s, reaching a level around Rs 16,000 crore by March 2010. The current level of debt, amounting to 71.3% of total funds raised by the leading MFIs, represents a reduction from the highest level of 80% reached in 2008.

The domination of commercial bank funds in Indian microfinance is under-played here since it excludes off-balance sheet financing via portfolio sales and securitisation of portfolio undertaken by some of the leading MFIs. A separate compilation of the portfolio managed by MFIs for others shows that the amount is around Rs 4,000 crore, an additional 20% of the portfolio on the MFI's balance sheets. While some institutional debt is still available at concessional rates-partly because banks are able to classify such lending as 'priority sector' directed credit-much of this debt is at commercial rates in the range 10-14% per annum for wholesale lending.

The share of net worth in MFI funds has now increased to 17.7% as retained earnings have grown and some of the leading MFI promoters have made extensive efforts to raise additional funds as equity through private placements by both social investors and private equity funds. Equity now amounts to 10.7% of total MFI funds, with retained earnings accounting for the rest of net worth; donor funds have declined to negligible levels. The 4.3% savings orientation of Indian MFIs is very low by global standards. All Asian countries with flourishing microfinance sectors – Bangladesh, Indonesia, the Philippines – have deposit ratios that account for significant proportions of portfolio. Also, the rural banking system in India undertakes all its lending from deposits.

The unwillingness of the regulator to permit MFIs, despite their outreach, to generate deposits is thus a significant impediment to financial inclusion. It has also forced MFIs into a uni-dimensional relationship with clients, a feature that limits their client orientation. The use of funds is broadly optimal though allocation to portfolios is restricted by bulk inflows.

Of the total resources of Rs 23,623 crore deployed in microfinance by the 66 main MFIs, nearly 69% is deployed in loans to clients. This is below the portfolio allocation level of the MIX international median of 76.8% largely because of the prevalent practice in India of lenders making substantial disbursements in the last week of March (the end of the financial year). This enables the banks to include the disbursed amount in their priority sector lending achievements but does not leave time for the MFIs to disburse the funds to their end-clients before the closing of accounts for the financial year.

Microfinance is defined as the provision of thrift, credit and other financial services such as money transfer and micro-insurance products for the poor, to enable them to raise their income levels and improve living standards. Is microfinance an input for micro entrepreneurial activities or is it an industry worth promoting for rural business to flourish? It is being increasingly debated that the micro enterprise development model is not relevant for manufacturing enterprises and growth as only 20 per cent of micro business startups go on to flourish. For poorer countries with a large proportion of the population below poverty levels, the emphasis should continue to be on microenterprise development and whether micro-finance as an industry flourishes or fails is of little relevance today. Possibly, with more education and better prosperity levels some years down the line, a debate may be held as regards their relative merits as economic growth models. Today, the need is to ensure the survival of poor people with little skills or education and without any safety net who are required to earn a livelihood even in resource-poor regions. The goal of microfinance is to ensure that the poor are enabled to meet their funds requirements in emergencies or set up microenterprises to earn their livelihoods.

Microfinance refers to the entire range of financial services such as savings, money transfers, insurance, production and investment credit as also housing finance and include the need for skill upgradation and entrepreneurial development that would enable them to overcome poverty. Microfinance provides credit support in small doses along with training and other related services to people who are resource-poor but who are able to undertake economic activities.

Microfinance rests on the following principles:

- Self-employment/enterprise formation is a viable means for poverty alleviation.
- Lack of access to capital assets/credit is a constraint for existing and potential microenterprises.

- The poor are able to save despite their low-level and sporadic incomes.

Microfinance concepts have existed since 1904, when the Cooperative Societies Act was passed for ensuring production credit loans for farmers through primary credit societies. The formation of long-term cooperative credit institutions to meet investment needs of farmers started in 1928. The Syndicate Bank, started in 1921, concentrated on raising micro-deposits in the form of daily/weekly savings and also sanctioned micro-loans for its constituents. With the various priority sector targets under social banking in 1967 and after bank nationalization in 1969, microfinance concepts in banking institutions once again came to the fore. However, in the rural areas, the moneylenders and traders did extend loans at high rates of interest and even for consumption purposes. Under priority sector norms, microfinance was extended for investment credit purposes but included elements of production credit and even consumption credit! The Integrated Rural Development Programme and the revamped programme named as Swarnajayanti Grameen Swarozgar Yojana (SGSY), laid emphasis on investment credit needs only. But the subsidies and low interest rates ensured that the rural poor did not receive these loans which were instead cornered by the better-off sections of the rural people. Also, repayment rates were poor possibly due to 'rent costs' incurred by the borrowers and poor monitoring and follow-up by bankers. With the NABARD programme on self help groups (SHGs) in 1992, the emphasis shifted to loans without collateral, 100 per cent repayment norms and lending to groups of people who would also invest their savings and regulate their groups and group loans, thus reducing transaction costs for the borrowers and for the banks. Other innovative concepts were sanctioning of production-cum-consumption loans, unregulated interest rates, weekly/monthly savings and loan repayments.

CONCLUSION

Microfinance institutions in India were until recently the poster-child for profitable lending to the poor, and India was one of the fastest growing microfinance markets in the world. Today, with the crisis set to ricochet beyond Andhra Pradesh, a number of micro lenders face collapse that could send poor clients back to village moneylenders.

Across the globe and in India the microcredit revolution of the past few decades-microfinance proved that it is possible to deliver financial services to poor people at a large scale, free from subsidies. As a result, millions of poor households today have access to services to manage house-hold finances more effectively. The crisis in Andhra Pradesh presents an opportunity for microfinance a vision of microfinance that is based on poor customers' needs, not just credit.

Consider the story of the world's most famous microfinance bank, Grameen Bank, founded by Muhammad Yunus in Bangladesh. Twenty years after its founding, in the 1990s, Grameen Bank found itself at a crisis point: floods had devastated the country, poor clients were unable to pay back loans, and Grameen needed new sources of funds. Grameen converted from a microcredit organisation into a full-service bank. Grameen II, as the new incarnation of the bank is known, offers savings as well as loans. Poor clients living on around $2 a day have access to health insurance, life insurance, and a pension fund. Today with over 8 million poor women as its clients, the bank is profitable and finances 100% of its loans from the deposits of poor clients.

Today the landscape of microfinance providers looks radically different from how it looked just a few years ago: mobile network operators, payment cards, state and commercial banks, and post offices, are all part of a disaggregated business model vying for poor people's business. New technologies such as mobile phones are making it possible to deliver high quality financial services to low-income populations.

As business models evolve, and new players come in, many of the inefficiencies that made it difficult to reach the poorer are fast disappearing. Traditional MFIs, which played such a key role in getting credit to the poor, still have a key role to play, often as the customer interface.

The evolving face of finance for the poor needs policies that will kick-start innovations. Enlightened regulators understand that they have an active role to play not just in protecting poor people's money, but in advancing access to the full range of services that will help them manage their house-hold finance more effectively.

The G-20 has taken up the cause of innovation in financial access, recognising that it's not just about extending credit. What poor people need is the ability to manage their own household cash flow. So they can save for emergencies, pay school fees when needed, send money to relatives, and invest in their small businesses.

The G-20 recognises that access to a broad range of financial services is as much part of a country's basic infrastructure as access to roads, or electricity, or the Internet.

Microfinance is not just about new technology and new business models; it also requires policies that balance the interests of good business with the needs of the poor. Socially-motivated investors should be part of the solution, directing their investments to many places where no financial services exist for the poor.

For too long we've let a few do-good organisations offer poor people credit and called that financial access. It's time to move beyond credit and embrace a real vision of financial inclusion-financial inclusion that provides poor people with a full set of choices to manage their household finances.

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