International Journal of Academic Research and Development
ISSN: 2455-4197, Impact Factor: RJIF 5.22
www.academicsjournal.com
Volume 1; Issue 6; June 2016; Page No. 51-56

Micro finance in India

Kusam Rani

Assistant Professor, Department of Economics S.D. (PG) College, Panipat, Haryana India

Abstract

Microfinance is a form of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking. Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Microcredit is one of the aspects of microfinance and the two are often confused. Critics may attack microcredit while referring to it indiscriminately as either 'microcredit' or 'microfinance'.

Keywords: Micro, Credit, Service, Banking

Introduction

Loans to poor people by banks have many limitations including lack of security and high operating costs. As a result, microfinance was developed as an alternative to provide loans to poor people with the goal of creating financial inclusion and equality.

Muhammad Yunus, a Nobel Prize winner, introduced the concept of Microfinance in Bangladesh in the form of the "Grameen Bank". The National Bank for Agriculture and Rural Development (NABARD) took this idea and started the concept of microfinance in India. Under this mechanism, there exists a link between SHGs (Self-help groups), NGOs and banks. SHGs are formed and nurtured by NGOs and only after accomplishing a certain level of maturity in terms of their internal thrift and credit operations are they entitled to seek credit from the banks. There is an involvement from the concerned NGO before and even after the SHG-Bank linkage. The SHG-Bank linkage programme, which has been in place since 1992 in India, has provided about 22.4 lakh for SHG finance by 2006. It involves commercial banks, regional rural banks (RRBs) and cooperative banks in its operations. Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to the poor and low income households and their micro-enterprises. Microfinance is defined as “Financial Services (savings, insurance, fund, credit etc.) provided to poor and low income clients so as to help them raise their income, thereby improving their standard of living” Micro-financing is regarded as a tool for socio-economic up-liftment. It is expected to play a significant role in poverty alleviation and development. It is emerging as a powerful tool for poverty alleviation in India the prospect of Micro-Finance is dominated by SHGs (Self Help Groups) - Banks linkage Program. Its main aim is to provide a cost effective mechanism for providing financial services to the poor. Number of the poor continued to remain outside the fold Micro Finance may be defined as "provision of thrift, the wide network of the organized banking system deep credit and other financial services and products of very into rural areas. Market and the government both failed to small amounts to the poor in rural, semi urban or urban provide credit access to the poor. In fact the failure of areas, for enabling them to raise their income levels and institutional initiatives of rural credit and to the improve living standards". At present, a large part of weaknesses of the exploitative informal system of credit micro finance activity is confined to credit only. Institutions The proposed Microfinance Services Regulation Bill of India1 defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for: i. an amount, not exceeding rupees fifty thousand in aggregate per individual, for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual) or ii. an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing purposes, or iii. Such other amounts, for any of the purposes mentioned at items (i) and (ii) above or other purposes, as may be prescribed.” Microfinance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. microfinance 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., microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

Features of microfinance

- Loan given without security
- Loans to those people who live below the poverty line
- Members of SHGs may benefit from micro finance
- Terms and conditions offered to poor people are decided by NGOs
- Microfinance is different from Microcredit- under the latter, small loans are given to the borrower but under microfinance alongside many other financial services including savings accounts and insurance. Therefore, microfinance has a wider concept than microcredit.
- It is an essential part of rural finance.
- It deals in small loans.
- It basically caters to the poor households.
- It is one of the most effective and warranted Poverty Alleviation Strategies.
- It supports women participation in electronic activity.
- It provides an incentive to grab the self-employment opportunities.
- It is more service-oriented and less profit oriented.
- It is meant to assist small entrepreneur and producers.
- Poor borrowers are rarely defaulters in repayment of loans as they are simple and God-fearing.

Principles of Micro finance

- Poor people need a variety of financial services such as savings, insurance and money transfer services, not just loans. Microfinance is a powerful tool to fight poverty. It must be useful to poor households: helping them raise income, build up assets and/or cushion themselves against external shocks.
- Microfinance also means integrating the financial needs of poor people into a country's mainstream financial system.
- Microfinance can pays for itself, and must do so if it is to reach very large numbers of poor people.
- Microfinance is about building permanent local financial institutions that can attract domestic deposits, recycle them into loans, and provide other financial services.
- Microcredit is not always the answer. Other kind of support may work.
- Interest rate ceilings hurt poor people by preventing microfinance institutions from covering their costs, which chokes off the supply of credit.
- Microfinance institutions should measure and disclose their performance-both financially and socially.
- The job of government is to enable financial services, not to provide them directly.
- Donor funds should complement private capital, not compete with it.
- The key bottleneck is the shortage of strong institutions and managers.

Objectives of microfinance

The organizations working to promote microfinance institutions in different parts of the world determine various objectives to microfinance. The important among them are listed as follows.

1. Promote socio-economic development at the grass root level through community-based approach
2. Develop and strengthen people’s groups called Self-Help Groups and facilitate sustainable development through them
3. Provide livelihood training to disadvantaged population.
4. Promote activities which have community participation and sharing of responsibilities
5. Promote programs for the disabled
6. Empower and mainstream women
7. Promote sustainable agriculture and ecologically sound management of natural resources
8. Organize and coordinate networking of grass root level organization
9. Get benefits by reducing expenditure and making use of local resources as inputs for livelihood activities
10. Increase the number of wage days and income at household level

Major Models of Microfinance

The literature on microfinance listed 12 various models of microfinance institutions working in different countries. This classification is on the basis of regulatory structure and operational methods. Few models are not common in international level and few others are complimentary. NGOs and self-help groups are example. Most of the self-help groups have a promoter NGO. At the same time many NGOs have direct microfinance chains. Like that commercial banks are implementing microfinance operations through its SHGs. In these cases two models are working together to serve poor. Some models are working in the informal sector only. Major models are grameen, village bank; credit union, cooperatives, self-help groups, commercial banks, NBFCs, Association of persons, nidhi model, community banking, NGOs and ROSCAs.

i) Recent History of Micro Finance in India

Microfinance operation is not a new concept in the financial transactions. There were different forms of credit and lending activities existed in different parts of the world since the development of human history 3. It includes individual money lending, various types of chitties, and also kurikkalyanam in Malabar area of Kerala. All these indigenous financial institutions were conducted microfinance activities in one way or the other. But modern types of microfinance were started its development since later half of 20th century especially after 1970. Our country also witnessed the development of such like institutions in the same period. Government’s initiative to reduce poverty by improving access to financial services to poor started since independence. India‘s overwhelming majority of poor is located in rural areas and this motivated the government to give special attention to rural credit. Following the report of All India Rural Credit Survey in mid 1950’s, the government took crucial steps in reviewing Cooperative structure including the partnership of State in cooperatives. Also the policy initiative of ‘social banking’ concept led to the nationalization of commercial banks, adoption of direct lending programmes to rural areas and development of credit institutions such as Regional Rural Banks (RRBs) and National Bank for Agriculture and Rural Development (NABARD). The microfinance sector has emerged mostly from the efforts of Nongovernmental Organizations (NGOs), and as a response to the failure of existing structures to deliver financial services to the poor. The efforts by NGOs have emerged from grassroots and represent diversity. They do not fit into a straitjacket. Therefore, unlike the other structures like cooperatives, Regional Rural Banks (RRBs) and commercial banks, it is difficult to get statistics on microfinance. It is also difficult to make policy recommendations that impact the sector as a whole. There are different channels for microfinance services in the country. SHG (Self Help Group)-Bank Linkage Channel (SBLC) is the first one, which was developed early 1990s by NABARD. More recently, many Non-Governmental Organizations (NGOs), Community Based Organizations (CBOs) and Self Help Groups have started micro finance delivery systems successfully in rural areas. These organizations motivate the poor to join the credit groups, helps to manage their savings, loan-deposit and recovery process and may also provide an interest free loan to the group that acts as a start-up fund4. The second channel is Micro Finance Institution (MFI). The MFI in India was first introduced in 1974, but the momentum was achieved only during the 1990s. In the country Self Employed Women's Association (SEWA) Bank is the oldest micro 104 Finance organization. It was founded in 1974 in Ahmadabad, Gujarat as a trade union first, started organizing self-employed women. Initially the formal financial institutions were reluctant to be involved with the MFIs, and social entrepreneurship was also in short supply. But after 1990s banks and other financial institutions, helped by supportive public policies, have become more aware of the commercial viability of the micro finance services. Innovative partnership models have been developed between the banks and the MFIs. These have pumped huge funds to the sector and have subsequently enabled MFIs to increase their scale of operations and outreach. It has witnessed tremendous growth of microfinance over the last two decades. A Microfinance Information Exchange5 (MIX) survey involving 78 countries revealed that India's microfinance sector saw the largest per-MFI percentage increase in active borrowers in 2005 than any other country. According to microfinance Sector report of the ACCESS alliance, the MFI operations expanded by 13 times in four years to end the year 2009. Whereas there was only one for-profit MFI in the country in the middle of the 1990s, this number had spiraled to 149 registered micro finance institutions by 2009. Of these, about 11 per cent of the large micro finance companies had a disproportionally larger share in the credit market, having 82 percent of the clients and controlling about 88 per cent of the loan portfolio6. There are several legal forms of MFIs. However, firm data regarding the number of MFIs operating under different forms is not available. Therefore it is no uniformity in the number of MFIs we got from different sources. Rangarajan (2008)7 estimated that there are about 1,000 NGO-MFIs and more than 20 Company MFIs. Further, in Andhra Pradesh, nearly 30,000 cooperative organizations are engaged in 105 microfinance activities. However, the companies MFIs are major players accounting for over 80% of the microfinance loan portfolio. There are more than 2000 NGOs involved in the NABARD SHG-Bank linkage program. Out of these, approximately 800 NGOs are involved in some form of financial intermediation. Further, there are 350 new generation co-operatives providing thrift and credit services. During the last decade, the union and state governments has considered microfinance as a tool to meet the financial service requirements of the poor8. It has framed policies that enable the increased access to financial services for the poor. Series of measures are introduced for the same.

ii) Micro Finance Models in India

A wide range of microfinance models are working in India. Experts opinion is that India host the maximum number of microfinance models. Each model has succeeded in their respective fields. The main reason behind the existence of these models in India may be due to geographical size of the country, a wide range of social and cultural groups, the existence of different economic classes and a strong NGO movement. Micro Finance Institutions in India have adopted various traditional as well as innovative approaches for increasing the credit flow to the organized sector. They can be categorized into six broad types. 1) Grameen model 2) SHG model 3) Federated SHG model 4) Cooperative Model 5) ROSCA s 6) Micro-finance companies (MFCs) 3.6 a. The Grameen Model the Grameen model has been a case of exceptional success in Bangladesh. It turns out that many organizations in India have adopted the Grameen Bank model with little variations. Some of the notable examples are SHARE Microfinance 107 Limited, Activists for Social Alternatives (ASA) and CASHPOR Financial and Technical Services Limited. Self Help Groups (SHGs). An SHG is a group of five to 20 people from same income category formed on principle of lending their own savings. They also seek external funding to augment these resources. This group is a voluntary one, formed on the areas of common interest so that they can think, organize and operate for their own development. The SHGs function on the basis of co-operative principles and provide a forum for members to extent support to each other. SHGs play a crucial role in improving the savings and credit and also in reducing poverty and social inequalities. Almost 90% of the SHGs in India are female only due to the known fact that world's poorest households tend to rely more heavily on income generated 109 by women of the house. In India, SHGs have been the most popular way to help the poor and make them bankable. MFls include NGOs, trusts, social and economic entrepreneurs, these lend small, sized loans to individuals or SHGs. They also provide other services like capacity building, training, marketing of products etc.

Role and Importance of Microfinance

Microfinance institutions are those which provide credit and other financial services and products of very small amounts to poor in rural, semi-urban and urban areas for enabling them to raise their income and improve their standard of living.

Credit to Rural Poor
Usually rural sector depends on non-institutional agencies for their financial requirements. Micro financing has been successful in taking institutionalized credit to the doorstep of poor and have made them economically and socially sound.

Poverty Alleviation
Due to micro finance poor people get employment. It also helps them to improve their entrepreneurial skills and encourage them to exploit business opportunities. Employment increases income level which in turn reduces poverty.

Women Empowerment
Normally more than 50% of SHGs are formed by women. Now they have greater access to financial and economic resources. It is a step towards greater security for women. Thus microfinance empowers poor women economically and socially.

Economic Growth
Finance plays a key role in stimulating sustainable economic growth. Due to microfinance, production of goods and services increases which increases GDP and contributes to economic growth of the country.

Mobilization of Savings
Microfinance develops saving habits among people. Now poor people with meagre income can also save and are bankable. The financial resources generated through savings and micro credit obtained from banks are utilised to provide loans and advances to its members. Thus microfinance helps in mobilization of savings.

Development of Skills
Micro financing has been a boon to potential rural entrepreneurs. SHGs encourage its members to set up business units jointly or individually. They receive training from supporting institutions and learn leadership qualities. Thus micro finance is indirectly responsible for development of skills.

Mutual Help And Co. operation
Microfinance promotes mutual help and Co-Operation among members. The collective efforts of group promotes economic interest and helps in achieving socio-economic transition.

Social Welfare
With employment generation the level of income of people increases. They may go for better education, health, family welfare etc. Thus micro finance leads to social welfare or betterment of society. Building leadership qualities among group members (4) Motivating members for prompt repayment of credit (5) providing training to its members.

Problems Faced By Shgs
Regional Imbalance
Poor Management
Many SHGs suffer due to poor management. In many cases internal controls are lacking. There has been poor management of cash flows. Roles and responsibilities of members and office bearers are not defined properly. Clients are uneducated about debt management 70% of the clients in MFIs are unaware of the fact that how to manage their debt. Because of the lack of education and understanding on the part of the clients, they also cannot correctly manage the loans given to them. So for this reason debt management creates a problem in growth and expansion of the organization. Internal Environment High Transaction Cost: High transaction cost is a big challenge for microfinance institution. The volume of transactions is very small, whereas the fixed cost of those transactions is very high. It cannot vary with the size of the loan. The higher a producer’s fixed costs in the proportion of his total cost, the element of risk increases in the same proportion. Moreover, if the demand for the product falls or the marginal costs increases, it becomes very difficult to adjust the cost by cutting output. This cut will reduce revenue out of which he has to pay principal amount as well as interest on the loan. This needs to be rationalized

Problem of Micro Enterprises
Many micro enterprises developed by SHGs lack skills and strategy to survive. Even the NGOs fail to provide them with necessary linkage and market survey report.

Dropouts
There are many incidences of dropouts from groups. The main causes are migration for employment and inability to make regular savings. The dropout rate is 11% for very poor and 7% for non-poor.

Lack of Business Attitude
Many banks supporting SHGs treat the projects as a social or developmental programme and not as a business proposition. This has restricted the spirit of entrepreneurship among members.

Regulations
SHGs are governed by multiplicity of regulations. This makes their formation and functioning difficult. Micro Financial Sector Bill 2009 is expected to sort out this problem by making NABARD the single regulatory body for SHGs.

Lack of Political Support
Usually political parties are after Co-Operative Societies as they serve vote banks. A SHG does not contain enough votes to be inspired by politicians.

Sustainability
Sustainability of SHGs depend on the quality of SHGs and the support given by Self Help Promoting Institutions (SHPIs). Many SHPIs have been supporting SHGs, but

only to achieve targets. This affects its sustainability in long run.

Loan Default

Loan default is an issue that creates a problem in growth and expansion of the organization because around 73% loan default is identified in MFIs. Lack of understanding on the part of the clients, they also cannot correctly manage the loans given to them. As a result, they are not able to pay back the loan.

Low Education Level

The level of education of the clients is low. So it creates a problem in the growth and expansion of the organization because its percentage is around 70% in MFIs. Target population of MFIs is people of rural areas and they have no or less education level. As the percentage of people who have very less education.

Language Barrier

Language barrier makes communication with the clients (verbal and written) is an issue that creates a problem in growth and expansion of the organization because around 54% language barrier has been identified in MFIs. As the education level of clients is low so it is difficult to communicate with them. For this reason it is also difficult for the MFIs employees to make the clients to understand the policy and related details.

Late Payments

Late payments are an issue that creates a problem in growth and expansion of the organization because late payments are around 70% in MFIs. This usually occurs because clients are uneducated and they don’t know how to manage their debt. They are unaware of the fact that late payment increases their loan payments.

Lack of infrastructure

Around 60% of MFIs difficult to communicate with clients of far-flung areas. MFIs are basically aimed to facilitate the BPL population of the country but due to lack of infrastructure in those areas it becomes difficult to reach them.

Lack of access to Funding

Another factor contributing to the lack of growth in MFIs is that requisite financial support has not been provided to MFIs by concerned agencies. Around 68% of MFIs response was in favour of that government and SBP don’t support them to meet the funds requirement as MFIs cannot alone remove the poverty from the country.

Loan Collection Method

Loan Collection Method is found an issue that creates a problem in growing the organization. Around 55% of MFIs agrees that due to weak law and legislation they are not able to make their loan collection system as effective as they want to do so.

Fraud

Fraud is an issue that creates a problem in growth and expansion of the organization because its percentage is around 67% in MFIs. Mismanagement of loans on the part of the clients creates the problem of fraud and financial embezzlement on the part of clients.

Impact of microfinance

The impact of microcredit is a subject of much controversy. Proponents state that it reduces poverty through higher employment and higher incomes. This is expected to lead to improved nutrition and improved education of the borrowers' children. Some argue that microcredit empowers women. It is argued that microcredit helps recipients to graduate from welfare programs. Critics say that microcredit has not increased incomes, but has driven poor households into a debt trap, in some cases even leading to suicide. They add that the money from loans is often used for durable consumer goods or consumption instead of being used for productive investments, that it fails to empower women, and that it has not improved health or education. Moreover, as the access to micro-loans is widespread, borrowers tend to acquire several loans from different companies, making it nearly impossible to pay the debt back. As a result of such tragic events, microfinance institutions in India have agreed on setting an interest rate ceiling of 15 percent [55] this is important because microfinance loan recipients have a higher level of security in repaying the loans and a lower level of risk in failing to repay them. The available evidence indicates that in many cases microcredit has facilitated the creation and the growth of businesses. It has often generated self-employment, but it has not necessarily increased incomes after interest payments. In some cases it has driven borrowers into debt traps] There is no evidence that microcredit has empowered women. In short, microcredit has achieved much less than what its proponents said it would achieve, but its negative impacts have not been as drastic as some critics have argued. Microcredit is just one factor influencing the success of small businesses, whose success is influenced to a much larger extent by how much an economy or a particular market grows. For example, local competition in the area of lack of a domestic markets for certain goods can influence how successful small businesses who receive microcredit

Suggestions

Appropriate regulation and supervision:

Presently, there is no distinctive regulatory and standards for MFIs India. Therefore, there is a need for regulating framework for the MFIs in India. With appropriate regulation and supervision each institutional can bring leverage to solving the microfinance problem. For example, efforts are being made to link self-help groups to commercial banks, to network member-owned organizations together to achieve economies of scale and scope, and to support efforts by commercial banks to 'down-scale' by integrating mobile banking and e-payment technologies into their extensive branch networks.

Insurance Services

A small change in poor people’s earning has come under stress. So should be Provision of insurance under the microfinance programme.

- Ensure the uniform distribution of micro financing in SHG-BLP developed by NABARD is also providing both rural and urban areas of each states of India.
- India need to establish several Microfinance Institutions.

References

1. http://www. study mode.com/essays/Microfinance
2. Nisha Bharti, 2007. Microfinance http://www. bsp.gov. ph/archive/ Institutions in India: Issues and Challenges, IRMA
3. Microfinance sector report, ACCESS Alliance 2010
4. Fisher Thomas and Sriram MS. Beyond micro-credit-- Putting development back into Micro-finance. Vistaar Publications, New Delhi, 2002.