A STUDY ON WORKING OF MICROFINANCE SECTOR IN INDIA

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ABSTRACT

This study is concern with the a brief explanation of working and problems recently facing by the microfinance institutions (MFIs) in India and to conclude the appropriate suggestions for the smooth working and removing of the problems concerned with microfinance in India. Microfinance is a vibrant field and there is not another best way to provide help to poor and low income group people and hence many delivery models have been developed over a period of time. A large number of the poor and low income group people remain exempted from the help from the formal banking system, in spite of the wide spread of the banking system in rural areas due to which they are not able to get the appropriate opportunities to develop their source of income. Market and the government both are not able to provide the financial help to the poor people. Due to the disappointment of institutional initiatives of rural credit and to the weaknesses of the exploitative banking system of credit gave origin to Microfinance institutions. Uncertainty, microfinance has been successful in providing financial help to the poor and low income group people. But in recent times the role of microfinance has become controversial, with various sections raising objections and criticisms in this regard. On the above findings we observe so many problems are associated with the MFIs. The Microfinance institutions are lagging behind in terms of loan and credit the real needy, regional imbalance, a proper regulation etc. Internal, external and client based challenges are prevailing from starting of the MFIs in India. Finally in my view MFIs in India have so many lacunas in their running, though the MFIs paid an significant role in the poverty alleviation and improving the living standards of the poor. If the above shortcoming will be eliminate from the MFIs, it would have positive results on the economy, lead to greater efficiency and improvement of living standards of the thousands of poor.

KEYWORDS: Microfinance, credit, poverty

INTRODUCTION

Micro finance sector is origin in India in early 1980’s to provide the credit service to poor peoples. Microfinance can be defined as a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to poor and low-income households and their micro-enterprises. The some features of **Microfinance** are:

- It Borrow from the low income group
- It provide loan of small amount.
- It provide loan for short time.
- It provide loan with any security.
- Repayment can be made by frequent installments.

Loans are generally taken for the purpose of developing the source of income . The term "microfinance institution" now refers to a wide range of organizations dedicated to providing these services and includes NGOs, credit unions, co-operatives, private commercial banks, NBFCs and parts of State-owned banks . Microfinance is a dynamic field and there is clearly no best way to deliver services to the poor and hence many delivery models have been developed over a period of time. It is recognized as a human right to get the financial help. Escalating credit-delivery services and improving their approachability has always been an important element of Indian development strategy. A large number of the poor and low income group people remain exempted from the help from the formal banking system, in spite of the wide spread of the banking system in rural areas due to which they are not able to get the appropriate opportunities to develop their source of income Market and the government both are not able to provide the financial help to the poor people. Due to the disappointment of institutional initiatives of rural credit and to the weaknesses of the exploitative banking system of credit gave origin to Microfinance institutions. Uncertainty, microfinance has been successful in providing financial help to the poor and low income group people. But in recent times the role of microfinance has become controversial, with various sections raising objections and criticisms in this regard. This study provides a brief explanation of working and problems recently facing by the microfinance institutions (MFIs) in India and to conclude the appropriate suggestions for the smooth working and removing of the problems concerned with microfinance in India.

Importance of the study

- Micro finance is a program to help the poor rural low income group people to develop their source of income.
- It develops the entrepreneurship under rural people by providing the financial support at easy terms.
- Microfinance sector help in maintaining better lifestyle in villages.
- It also help the farmers and rural peoples by providing the tool to improve the profitability of agriculture sector
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Objective of the study

- To study the working of microfinance sector in India and analysis the potential for the microfinance institutions like NGOs, SHGs in the market.
- To find out the main difficulty face by microfinance sector in India.

Review of Literature:

S.Sarumathi1 and **Dr. K. Mohan** foundout that microfinance brought psychological and social empowerment than economic empowerment. Impact of micro finance is appreciable in bringing confidence, courage, skill development and empowerment.

M.S.Sriram and Rajesh S. Uphadhyayula studied the growth and transformation of microfinance sector in India and find out that transformation experience in India are very few and regulatory changes are required to allow microfinance sector to graduate in other legal forms as they grow organically.

Devraja T.S. has studied the India's achievement of the MDG of halving the population of poor by 2015 as well as achieving a broad based economic growth also hinges on a successful poverty alleviation strategy. In this backdrop, the impressive gains made by SHG-Bank linkage program in coverage of rural population with financial services offer a ray of hope.

Manisha Raj, in his research paper entitled "Microfinance Institutions in India and its Legal Aspects" states that Microfinance institutions have been proved a very important financial wing to incorporate the poor in very important financial wing to incorporate the poor in the financial sector.

Now on the other aspect like the challenges faced by the microfinance institutions **Mr.Badrudduza** found the positive results shown by MFIs in many countries but still there are a number of challenges before the microfinance industry, he shown in his paper.

Christa Wichterich examines the integration of women into the financial market and the role borrowers of microcredits play. She argues that lending to women and microcredits as a main source of income has brought a financialization of everyday life to Indian villages resulting in a feminization of indebtedness.

Rajesh and **Ravi** states in their paper, despite the role of microfinance is very good in poverty alleviation but the unethical and extortionist practices by MFIs led to arguably a draconian measure in its home turf Andhra Pradesh halting the industry in its tracks.

Microfinance in India/ Channels of Micro finance

In India microfinance operates through two channels:

1. **SHG – Bank Linkage Program**

This is the bank-led microfinance channel which was initiated by NABARD in 1992. Under the SHG model the members, usually women in villages are encouraged to form groups of around 10-15. The members contribute their savings in the group periodically and from these savings small loans are provided to the members. In the later period these SHGs are provided with bank loans generally for income generation purpose. The group's members meet periodically when the new savings come in, recovery of past loans are made from the members and also new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular. The SHGs are self-sustaining and once the group becomes stable it starts working on its own with some support from NGOs.

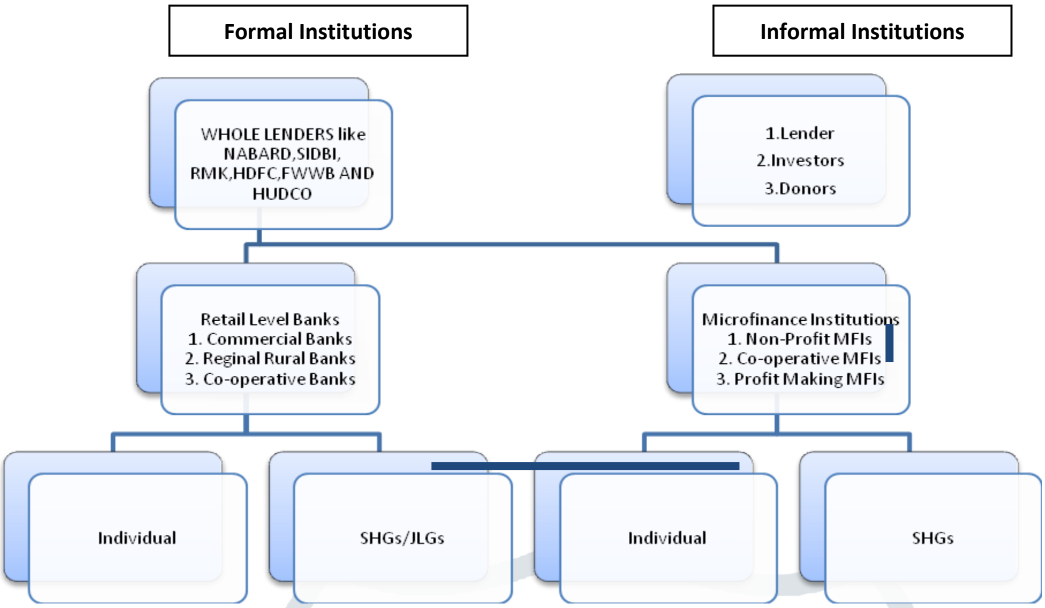
2. Micro Finance Institutions

Those institutions which have microfinance as their main operation are known as micro finance institutions. A number of organizations with varied size and legal forms offer microfinance service. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee. The different legal forms under which MF can be provided in India are:

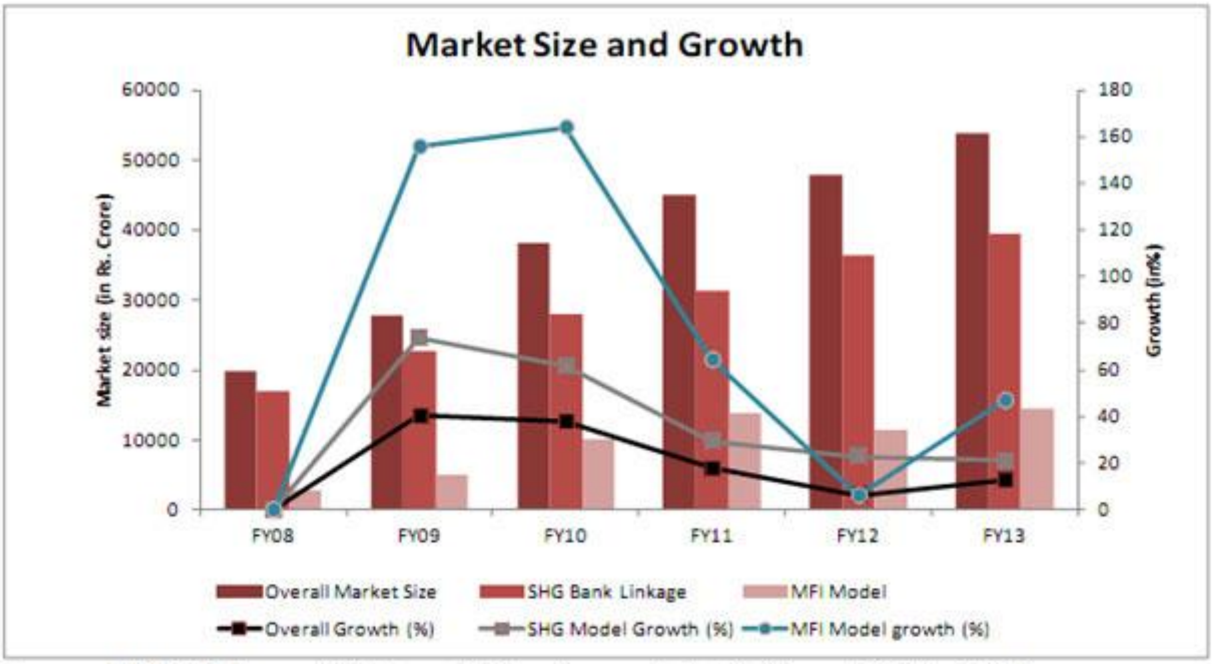
i. Commercial Banks
ii. Cooperative Banks
iii. Regional Rural Banks (RRBs)
iv. Local Area Banks (LABs)
v. Cooperative Societies, SHGs and Federations
vi. Societies
vii. Trusts
viii. Section 25 (Not-for-Profit) companies
ix. Non-Banking Finance Companies (NBFCs)
x. Organizations under Business Facilitator/Business Correspondent guidelines of the Reserve Bank of India

Among these, the MFIs can either take up the form of a Society, Trust, Co-operative Society, or NBFC. There is no centralized database on the number of microfinance institutions that operate in the country; however, estimates have put it anywhere between 800 and 1,200. The overwhelming majority of MFIs are societies and trusts, followed by cooperative and section 25 companies. Among the large MFIs, most are NBFCs. It is estimated that top 20 MFIs account for 80% of the total portfolio.

Hierarchy of Financial Institutions for Microfinance Disbursement



Institutional Arrangements for Microfinance Disbursement in India



Source: NABARD Report "Status of Microfinance in India" from FY09 to FY13

Legal and Regulatory Framework for the Microfinance Institutions in India:

Societies Registration Act, 1860:

NGOs are mostly registered under the Societies Registration Act, 1860. Since these entities were established as voluntary, not-for-profit development organizations, their microfinance activities were also established under the same legal umbrella. Mainpurpose is:

- Relief of poverty
- Advancement of education
- Advancement of religion
- Purposes beneficial to the community or a section of the community.

Indian Trusts Act, 1882:

Some MFIs are registered under the Indian Trust Act, 1882 either as public charitable trusts or as private, determinable trusts with specified beneficiaries/members.

Not-For-Profit Companies Registered Under Section 25 Of Companies Act,1 956:

An organization given a license under Section 25 of the Companies Act 1956 is allowed to be some of the provisions of the Companies Act, 1956.For companies that are already registered under the Companies Act, 1956, if the central government is satisfied that the objects of that company are restricted to the promotion of commerce, science, art, religion, charity or any other useful purpose; and the constitution of such company provides for the application of funds or other income in promoting these objects and prohibits payment of any dividend to its members, then it may allow such a company to register under Section 25 of the Companies Act.

Problems/ difficulties face by Microfinance institutions in India

Low approachability : In India, MFI approachability is very low in India. Microfinance sector focus greatly on women. In spite Women are better and more reliable clients, but in order to increase their approachability MFIs cannot focus on only one section of society. Men are also an important clients.

Table 1: Penetration Intensity of Microfinance

Top 5			
Name of State	MPI*	Name of State	MPPI**
Andhra Pradesh	3.64	Andhra Pradesh	6.35
Tamil Nadu	2.27	Tamil Nadu	2.77
Orissa	2.00	Kerala	2.49
Karnataka	1.57	Karnataka	1.74
W. Bengal	1.48	W. Bengal	1.65
Last 5			
Jammu and Kashmir	0.03	Jammu and Kashmir	0.13
Punjab	0.07	Bihar	0.14
Bihar	0.20	Punjab	0.22
Haryana	0.23	Madhya Pradesh	0.27
Gujarat	0.26	26 Uttar Pradesh	0.32

Source: NABARD

*The intensity of penetration of microfinance (also known as MPI)

- **Lack of scalability -** smaller microfinance systems often struggle to preserve the profitability and performance in these markets, as FI's experience high growth rates that result from getting the service delivery right. This results in thwarting the growth of these organizations.

Table 2: Growth Trends in Self-help Group Bank Linkage Program (SBLP)

	2006	2007	2008	2009	2010
No. of SHGs provided with bank loans	2238565	2924973	3625941	4224338	4587178
Average disbursed loan per group (`)	37574	44343	46800	74000	115820
Outstanding loans (`Rs. Billion)		123.66	169.99	226.79	272.66
Incremental groups million		0.69	0.70	0.60	0.36
Incremental loans outstanding (billion)			46.33	56.80	45.87

Source: NABARD

High transaction cost – generally micro credits fall below the break-even point of providing loans by banks. The volume of transaction is very low but the fixed cost for the transaction is very high.

Absence of collaterals –The poor usually are not in a state to offer collaterals to secure the credit.

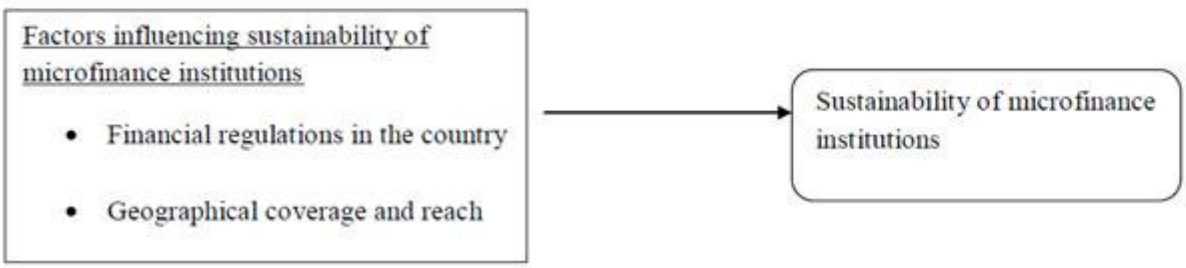
No Proper Regulation -Although the SHG-Bank linkage model is well managed in India by NABARD, currently there is no proper regulatory body for the supervision of MFIs. The presence of institutions with a variety of legal forms makes it difficult for the regulation of all such institutions by a single regulatory body in the current Indian legal structure. Though NBFCs, which cover the major part of the outstanding loan portfolio by the microfinance channel, are regulated by Reserve Bank of India, other MFIs like societies, trusts, Section-25 companies and cooperative societies fall outside the purview of RBI's regulation.

Financial illiteracy- One of the major hindrances in the growth of the microfinance sector is the financial illiteracy of the people. This makes it difficult in creating awareness of microfinance and even more difficult to serve them as microfinance clients. Though most of the microfinance institutions claim to have educational trainings and programmes for the benefit of the people, according to some of the experts the first thing these SHG and JLG members are taught is to do their own signature. The worst part is that many MFIs think that this is what financial literacy means. We all know how dangerous it can be when one doesn't know how to read but he/she knows how to accept or approve it (by signing it).

Inability to generate sufficient funds- Inability of MFIs to raise sufficient fund remains one of the important concern in the microfinance sector. Though NBFCs are able to raise funds through private equity investments because of the for-profit motive, such MFIs are restricted from taking public deposits. Not-for-profit companies which constitute a major chunk of the MFI sector have to primarily rely on donations and grants from Government and apex institutions like NABARD and SIDBI. In absence of adequate funding from the equity market, the major source of funds for MFIs are the bank loans, which is the reason for high Debt to Equity ratio of most MFIs.

• **Quality of SHGs (Self Help Groups) -** Due to the fast growth of the SHG-Bank Linkage Programme, the quality of MFIs has come under stress. This is due to various reasons such as:

- The intrusive involvement of government departments in promoting groups
- Diminishing skill sets on part of the MFIs members in managing their groups.
- Changing group dynamics.



Dropouts and Migration of group members- Majority of the microfinance loans are disbursed on group lending concept and a past record of the group plays an important role in getting new loans either through SHG-Bank linkage or through MFIs. The two major problems with the group concept are dropouts (when one or more members leave the group) and migration (when one or more members move to another group). Most MFIs lend on the basis of the past record of the group i.e. SHG or JLG and also on the individuals repayment performance. In absence of a decent past record, members are deprived of getting bigger loan amounts and additional services.

Transparent Pricing- Though the concern about the transparent pricing in the microfinance sector has been an older one, it is gaining significance with the growing size and the increasing competition in the sector. Non-transparent pricing by MFIs confines the bargaining power of the borrowers and their ability to compare different loan products, because they don't know the actual price. In absence of the proper understanding of the pricing, clients end up borrowing more than their ability to payback which results in over-indebtedness of the borrower.

Cluster formation – fight to grab established market- MFIs' drive to grab an established market and reduce their costs is resulting in formation of clusters in some areas leaving the others out of the microfinance outreach. By getting an established microfinance market, MFIs reduce their initial cost in group formation of clients, educating them and creating awareness about microfinance. This is one of the reasons for the dominance of the microfinance sector in the southern states. Now the problem is that a similar trend is being followed in the northern states as well. We have already seen what happened in A.P and it seems that most of the MFIs have not taken a lesson from the Andhra crisis.

Multiple Lending and Over-Indebtedness- Both of these are outcome of the competition among the MFIs. Microfinance is one such sector where the Neo-liberal theory of free market operation fails, at least to some extent. Though competition is good for many sectors but in this case it is going against both the parties. In order to eat away each others' market share, MFIs are ending up giving multiple loans to same borrowers which in some cases is leading to over-indebtedness (a situation where the borrower has taken loans more than her/his repaying capacity) of the borrower. MFIs are getting affected because borrowers are failing to make payments and hence their recovery rates are falling, while over-indebtedness is making the borrower go to depression and in some cases forcing them to commit suicide.

Solutions for Microfinance sector

- Microfinance personal should be well equipped and trained with project management capabilities so as to be able to impart the knowledge to the borrowers regarding self reliance project.
- Microloans should not be offered for any purpose loan just be issued for the sole purpose loans just be issued for the sole purpose of carrying out self reliance projects or enhancing already existing capabilities.
- The sole purpose of loans just be properly assessed by trained project management personnel so as to predict its sustainability before issuing outloans.
- Government should take up some kind of rehabilitation schemes for the very destitute in the community as microfinance loans is not suitable further since they may end up taking away their own lives as a result of being caught in a dept traps.

CONCLUSION

On the above findings we observe so many problems are associated with the MFIs. The Microfinance institutions are lagging behind in terms of loan and credit the real needy, regional imbalance, a proper regulation etc. Internal, external and client based challenges are prevailing from starting of the MFIs in India. Finally in my view MFIs in India have so many lacunas in their running, though the MFIs paid an important role in the poverty alleviation and enhancing the living standards of the poor. If the above shortcoming will be eliminate from the MFIs, it would have positive results on the economy, lead to greater efficiency and improvement of living standards of the thousands of poor. Sothat microfinance personal should be equipped and trained with project management capabilities so as to be able to impart the knowledge to the borrowers regarding self reliance project.

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