Study on Micro Financing: Need for Innovation

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ABSTRACT

Micro finance means providing very poor families with very small loans (micro credit) to help them engage in productive activities /small businesses.

Micro Finance can contribute extremely to the financial inclusion of the poor without which it willbe difficult for them to come out of the vicious cycle of poverty. It is required to strengthen all the available channels of providing credit to the poor such as SHG- Bank Linkage programmes, Micro Finance Institutions, Cooperative Banks, State financial corporations, Regional Rural Banks and Primary Agricultural Credit Societies. The strength of the micro finance industry lies in its informality and flexibility which should be protected and encouraged. [15].

Key words: Micro finance, SHG, poverty, credit

I - INTRODUCTION

Microfinance is defined as any activity which consist of the provision of financial services suchas credit, savings, and insurance to individuals at low income which fall just above the poverty line defined by nationally and poor individuals which fall below that poverty line, withthe goal of creating social value. The creation of social value includes poverty to lighten and the broader impact of improving livelihood opportunities through the provision of capital formicro enterprise, and insurance and savings for risk mitigation and consumption smoothing.[16].

Using a range of microfinance delivery methods in India, a vast variety of actors provide microfinance. From the founding of the Grameen Bank in Bangladesh, many different actors have tried hard to provide access to financial services to the poor in creative ways.[16]. Governments have piloted national programs, NGOs have undertaken the activity of raisingdonor funds for on-lending, and some banks have partnered with public organizations ormade small inroads themselves in providing such services. This has effected in a wide definition of microfinance as any activity that targets poor and low-income individuals for the provision of financial services. [16].

The range of different activities undertaken in micro finance include group lending, individual lending, the provision of savings and insurance, capacity building,and agricultural business development services. Whatever the form of activity however, theoverarching goal that unifies all actors in the provision of microfinance is the creation of social value.[16].

Micro finance Definition

As per International Labor Organization (ILO), ― Micro finance is an economic development approach which provides financial services through institutions to low income clients.[15].

II. RESEARCH METHODOLOGY

Research Objectives

1. To find out the micro finance issue

2. Comparative Analysis of Micro-finance Services offered to the poor.

3. To check the difference between the client of two main micro finance models, the SHG and the MFImodel.

4. To check the level of indebtedness to moneylenders depend on the type of micro finance model one is client of.

Descriptive study based on secondary data

Data sources: The research is based on secondary data and the data is collected from various sources such as, websites, Journals, Magazines, Articles and Research Paper.[15].

III. FUNCTIONS OF MICRO FINANCE

Different functions of Micro finance are Small loans, typically for working capital; Informal appraisal of borrowers and investments; access to repeat and larger loans based on debt capacity and repayment performance;
and secure savings products. [15].

MICRO FINANCE IN INDIA

At present lending to the economically active poor both rural and urban is pegged at around Rs 7000 crores in the Indian banks' credit outstanding. As against this, according to even the most conservative estimates, the total demand for credit requirements for this part of Indian society is some wher around Rs 2,00,000 crores. [15].

Deprived of the basic banking facilities, the rural and semi urban Indian masses are still relying on informal financing intermediaries like money lenders, family members, friends etc. [15].

Starting in the late 1960s, India was the home to one of the largest state interventions in the rural credit market. This phase is known as the ―So cial Banking phase. This is witness of the nationalization of existing private commercial banks, massive expansion of branch network in rural areas, mandatory directed credit to priority sectors of the economy, subsidized rates of interest and creation of a new set of regional rural banks (RRBs) at the district level and a specialized apex bank for agriculture and rural development (NABARD) at the national level.[15].

Microfinance Social Aspects

There is significant contribution of micro financing institutions to gender equality and women's empowerment as well as pro poor development and civil society strengthening. With contribution to women's ability to earn an income led to their economic empowerment, increased wellbeing of women and their families and wider social and political empowerment. [15].

Major initiatives in Rural Credit

Government has taken initiative to reduce poverty by improving access to financial services to poor from the independence. India's very great amount of poor is located in rural areas and due to this the government is motivated to give special attention to rural credit. As per the report of All India Rural Credit Survey in mid 1950's, the State took crucial steps in reviewing Cooperative structure including the partnership of State in cooperatives. [15].

SEWA Co-operative Bank (1974)

Different difficulties due to the implementation of formal lending programmes towards the poor are exact targeting, screening problems of disting uishing good and bad borrowers and usually lending agencies won't be able to ensure the productive usage of loans. Also, the high transaction costs incurred in lending to the poor made the form all ending agencies leave the poor un-banked. [15].

Self Help Groups (SHGs)

During seventies and the Fourth Five Year Plan focused due to government initiatives on small and arginal farmers and agricultural labourers. Integrated sustainable income generation activity was promoted under Integrated Rural Development Programme. Many insufficiencies deep rooted in running programs focussed on individual households called for shift to a group based approach. The MYRANDA has taken the first step towards setting up self help groups (SHGs) and it built upon rural chit funds and informal lending networks to evolve a credit management group. [15].

National Bank for Agriculture and Rural Development

In 19991-92, NABARD launched the SHG-Bank Linkage Programme on a pilot basis to finance SHGs across the country through the formal banking system. High repayment rates by the SHGs encouraged the banks to finance SHGs. [15].

Small Industries Development Bank of India (SIDBI), 1994

A pilot scheme to provide financial assistance by way of loans to NGO's for providing credit to the poor households, especially women was launched by Small Industries Development Bank of India (SIDBI) in 1994. To build capacity of the intermediates and end-users, a small amount of grant also accompanied the loans. The programme did not achieve the desired objective. A large number of NGOs were not able to upscale their lending operations because of difficulties like interest rate cap on lending, security stipulations etc. [15].

IV. SELF HELP GROUPS (SHGs)

Self- help groups (SHGs) play today a major role in poverty alleviation in rural India. The increasing number of poor people (mostly women) in various parts of India are members of SHGs and actively engage in savings and credit (S/C), and also in other activities (income generation, natural resources management, literacy, child care and nutrition, etc.). The S/Cfocus in the SHG is the most prominent element and offers a chance to create some control over capital, albeit in very small amounts. This system is very relevant and effective in offering women the possibility to break gradually away from exploitation and isolation and it is proved [15].

How SHGs save

Self-help groups mobilize savings from their members, and may then on-lend these funds toone another, usually at apparently high rates of interest which reflect the members' understanding of the high returns they can earn on the small sums invested in their microenterprises, and the even higher cost of funds from money lenders [16].

Life insurances for self-help group members

The United India Insurance Company has designed two PLLIs (personal line life insurances) for women in rural areas. The company will be targeting self-help groups, of which there are around 200,000 in the country, with 15-20 women in a group [15].

V. MICRO FINANCE MODELS

Bank Partnership Model

This model is an innovative way of financing MFIs. The bank is the lender and the MFI acts as an agent for handling items of work relating to credit monitoring, supervision and recovery. In other words, the MFI acts as an agent and takes care of all relationships with the client, from first contact to final repayment. The model has the potential to significantly increase the amount of funding that MFIs can leverage on a relatively small equity base.

Service Company Model

Under this model, the bank forms its own MFI, perhaps as an NBFC, and then works hand in hand with that MFI to extend loans and other services. On paper, the model is similar to the partnership model: the MFI originates the loans and the bank books them [15].

Partnership Models

A model of microfinance has emerged in recent years in which a microfinance institution (MFI) borrows from banks and on-lends to clients; few MFIs have been able to grow beyond a certain point. Under this model, MFIs are unable to provide risk capital in large quantities, which limits the advances from banks. In addition, the risk is being entirely borne by the MFI, which limits its risk-taking. [15].

Bandhan

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. [15].

Bandhan opened its first microfinance branch at Bagnan in Howrah district of West Bengal in July 2002 [15].

Operational Methodology

Bandhan follows a group formation, individual lending approach. A group of 10-25 members are formed. The clients have to attend the group meetings for 2 successive weeks. 2 weeks hence, they are entitled to receive loans. The loans are disbursed individually and directly to the members. [15].

Grameen Bank

Prof Muhammed Yunus of Grameen Bank pioneered the Grameen Model which was by is perhaps the most well known, admired and practised model in the world. The model involves the following elements. [15].

Homogeneous affinity group of five.

Eight groups form a Centre.

Centre meets every week.

Regular savings by all members [15].

SKS Microfinance

Many companies say they protect the interests of their customers. Very few actually sit in dirt with them, using stones, flowers, sticks, and chalk powder to figure out if they will be able to repay a $20 loan at $1 a month. With this approach, this company has created its own loyal gang of over 2 million customers. [15].

Its model is based on 3 principles-

1. 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 [16].

2. To 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. [15].

3. To use Technology to reduce costs and limit errors- It could not find the software that suited its requirements, so it they built their own simple and user friendly applications that a computer-illiterate loan officer with a 12th grade education can easily understand [15].

VI. ISSUES IN MICROFINANCE

1. Sustainability

The first important challenge relates to sustainability. MFI model is costlier comparatively in terms of delivery of financial services. An analysis of 36 leading MFIs by Jindal & Sharma shows that 89% MFIs sample were subsidy dependent and only 9 were able to cover more than 80% of their costs [15].

2. Lack of Capital

The second area of concern for MFIs, which are on the growth path, is that they face apaucity of owned funds. This is a critical constraint in their being able to scale up. Many of the MFIs are socially oriented institutions and do not have adequate access to financial capital. As a result they have high debt equity ratios.[15]. Present ly, there is no reliable mechanism in the country for meeting the equity requirements of MFIs.

3. Financial service delivery

The next challenge for MFIs is the inability to access supply chain. This challenge can be defeat by exploring interaction between microfinance institutions with proficiency in credit delivery and community mobilization and businesses operating with production supply chains such as agriculture. [15].

4. HR Issues

The major challenge is Recruitment and retention faced by MFIs as they make great efforts to reach more clients and expand their geographical scope. Attracting the right talent proves difficult because candidates must have a previously defined mindset that fits with the organization's mission. [15].

5. Micro insurance

The developing products that really respond to the needs of clients and in a way that is commercially viable is the first big issue in the micro insurance sector. Secondly, there is strong need to enhance delivery channels as until now the status of these delivery channels is weak. Micro insurance companies offer minimal products and do not want to go forward and offer complex products that may respond better. [15].

6. Adverse selection and moral hazard

To overcome the basic two issues of adverse selection and moral hazard the joint liability mechanism has been relied. The group lending models are possible on the availability of skilled resources for group promotion and require a development period of six months to one year. However, there is not sufficient understanding of the drivers of default and credit risk at the level of the individual [15].

FINDINGS

Comparison of alternative microfinance model client In this study a moderate attempt has been made, this attempt help to recognize the change between the client characteristics of the two microfinance model which frequently used in the study area.[15].

Level of literacy

The head of the households interviewed were illiterate with 42 percent reporting they had never been school. [15].

Housing

With the focus on the rural area of our study, it interprets as no surprise that over 95 percent of our respondents live in the self owned place of residence.[15].

Land holdings and sources of income

Only 25 percent of the households were self employed among SHG clients. An compelling point to consider is that all the MFI clients were self employed and busy in dairy activities, owning small tea or tailoring shops and working as street hawkers [15].

VII. CONCLUSION & RECOMMENDATIONS

The fundamental scheme of micro financing is very simple that if poor people got the opportunity to approach to financial services which includes credit, there is possibility that they may very well expand a micro enterprise that will allow them to break out of poverty. [15].

In entirety the main focus is on removal of poverty form grass level, women raising by creating small and medium enterprises and thus takes care of development of any economy from within. This is done by comparing two microfinance models in the research area release that the level of indebtedness to moneylenders is higher in the case of clients of MFI model. [15].

Such examples explains the problems MFI clients' face when they have unfruitful financial requirements or they are drive to ensure proper timely and regular loan repayments through further borrowing from even money lenders. [15].

This makes poverty more serious in the short run, and makes it very hard to come out from poverty- and indeed can be source of poverty and non equal traps [15].

As public and private, both sector banks have the proficiency in financial intermediation, so they should come together and formulate a strategy at the national level to cover all regions of the country and to address the needs of the MFOs. [15].

To make easy the increase in micro credit, the Centre should prepare a representing bill on Money Lending and communicate it among the State Governments requesting them to accept similar state legislations. [15].

At current condition, both agencies government and the private are involved in micro finance have devised their own separate strategies in further steps of their goals. Absence of comprehensive national level policy has hindered the orderly growth of the sector. [15].

There is an immediate need for a concerted effort on the part of the many agencies and the services providers involved in the sector to come together to expand a coordinated strategy for a faster and smoother growth of the sector [15].

The absence of savings, apart from SHGs and MFI cooperatives, has regrettably been one of the characteristics of Indian Micro finance and it stops providing financial service to the poor people.

It is required to create awareness of the need to charge cost-recovering interest rates. The interest rate is charged by the MFIs depends upon the fund cost, delivery cost, payment cost, purchasing cost of bad debts and margins cost .[15].

A comprehensive study may be commissioned to study the incidence and result of subsidy as part of the 11thPlan and to work out modalities and long term strategies to use the subsidies more productively and effectively. [15].

The best practices for SHG-Bank linkages and microfinance may be issued by NABARD which covers mechanism for auditing and monitoring. RBI may conduct evaluation studies as per requirement. [16].

Need for extension services in the diversified economic activities of crop husbandry, animal husbandry, agro & rural industries is being widely recognised for guidance and counselling of SHGs or individuals, to help them to choose useful activities and obtain the required skills. [16].

Micro insurance should be recognized as the most important service in the financial needs package of the people and in coordination with micro savings and micro credit could go a long way in keeping the vulnerable segment away from the poverty trap and it could be an essential component of financial inclusion. [15].

Some financial institutions, particularly SIDBI, are tying up with capacity building providers which provide assistance to the microfinance institutions. A need-based capacity building programme to meet the requirements of all categories of MFOs is essential to bring about sustainability in the sector. Some of the important areas of capacity building are transformation, best practices, management of interest rate, management of delivery, managing growth, mitigation of risk and designing of product etc. [15].

The extra basic physical organization structure and facilities for capacity building may be created on PPP basis with appropriate government assistance. [15].

Laws for Borrowers / consumer protection may be designed to take care of offensive lending and collection practices with their definition and with proper provision making for effective complaint remediation mechanisms. [15].

With the intention of developing a detailed data base of the micro-finance sector, it is required to conduct periodic surveys of all the micro-finance organisations in the country and their operations. The survey can be conducted jointly by the NSSO and the state government.[15].

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