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CONTENTS

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INTRODUCTION
REVIEW OF LITERATURE
NEED/IMPORTANCE OF THE STUDY
STATEMENT OF THE PROBLEM
OBJECTIVES
HYPOTHESIS (ES)
RESEARCH METHODOLOGY
RESULTS & DISCUSSION
FINDINGS
RECOMMENDATIONS/SUGGESTIONS
CONCLUSIONS
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MICROFINANCE: ISSUES AND CHALLENGES IN INDIA

SEEMA
ASST. PROFESSOR
DEPARTMENT OF COMMERCE
INDIRA GANDHI UNIVERSITY
MEERPUR

ABSTRACT
Micro Finance may be defined as provision of thrift, credit and products of very small amounts to the poor people in rural, semi urban or urban areas, for enabling them to raise their income levels and improve living standards. Microfinance mechanism ultimately support poverty alleviation programme in India. This working paper tries to outline the prevailing condition of the Microfinance in India in the light of its emergence till now. The prospect of microfinance is dominated by SHG-(Self Help Group)-Bank linkage programme. The main aim of microfinance is to provide a cost effective mechanism of credit. This research paper highlights the hierarchy of microfinance institutions, delivery models and major challenges like regional disparity, high rate of interest, uneven growth of credit schemes, lack of insurance services etc. Finally this paper concludes with some suggestions to improve MFIs in India so that they fulfill the intent of their establishment.

KEYWORDS
microfinance SHGs, MFIs, SEWA NABARD, SIDBI, IDBI.

INTRODUCTION
Microfinance provides financial facilities to people who otherwise wouldn't have had access to such facilities. The scope of microfinance is wide in the sense that it isn't Confined to just providing credit but also helps the deprived class access to resources such as pension, s insurance etc. It discards the belief that the poor aren't credit worthy and devises methods that enable the poor to uplift themselves out of poverty. Clearly considering the growing disparities in the society, microfinance will play an effective role in the years to come, as we have seen in some African countries where MFI's have been more successful than the government in uplifting the lower classes. Microfinance refers to a movement that envisions a world in which low-income households have permanent access to a range of high quality and affordable financial services offered by a range of retail providers to finance income-producing activities, build assets, stabilize consumption, and protect against risk.

OBJECTIVE
This paper is an attempt to find out the challenges and issues relating to microfinance. How microfinance can play a significant role in financing the deprive segment of the Indian economy mainly poorer and small entrepreneurs.

REVIEW OF LITERATURE
The concept of providing financial services to low income people is very old. Many informal credit groups have been operating in many countries for several years like the Susus in Nigeria and Ghana, chit funds and Rotating Savings and Credit Associations (ROSCAs) in India, tontines in West Africa, pasanaku in Bolivia, Hui in China, arisan in Indonesia, paluwagan in Philippines etc. It is believed that initially, the informal financial institutions emerged in Nigeria dating back in the fifteenth century. Such type of institutions started establishing in Europe during the eighteenth century when in 1720 the first loan fund targeting poor people was founded in Ireland (Seibel, 2005). In the 1970s, a paradigm shift started to take place. The failure of subsidized government or donor driven institutions to meet the demand for financial services in developing countries led to several new approaches. Bank Dagan Bali (BDB), established in Indonesia in 1970, was the earliest bank to institute commercial microfinance (Schwiecker, 2004). In 1973, ACCION International, a USA based NGO, disbursed its first loan in Brazil at commercial interest rate to start a micro-enterprise. One year later in 1974, the Self-Employed Women's Association of India (SEWA) started a bank to provide loans to poor women. In 1976, Muhammad Yunus, a professor of Economics at Chittagong University, Bangladesh initiated an experimental research project of providing credit to the rural poor. He gave a small loan of 856 Taka ($27) from his pocket to 42 poor bamboo weavers and found that small loans radically changed the lives of these people and they were able to pay back the loans with interest. The success of this idea led Yunus to establish Grameen Bank in 1983 in Bangladesh. This programme showed astonishing growth rates in Bangladesh, particularly during the 1980s and 1990s. It encouraged social innovators and organizations all over the world to begin experiments with different microfinance delivery methods to bring financial services to the poor.

PROBLEM STATEMENT
For improving the living standard of poor people and to support in alleviation of poverty, the concept of Microfinance Institutions came into existence, but condition of BPL families have not yet improved. Which means Microfinance Institutions are facing challenges and unable to fulfill their original objective. With this study, here is an attempt to highlight those issues and provide recommendations for improvement.

BENEFITS OF STUDY
This paper helps in understating the situation of Microfinance institutions in India, what are the challenges they are facing and why high interest rates are being charged. Here in this research paper problem of microfinance are being analyzed at socio-cultural and educational level.

MATERIAL AND METHODS
This research paper is based on secondary data collected from various magazines, websites, journals, case studies and books.

MICROFINANCE IN INDIA
AN OVERVIEW
In India, the first initiative to introduce microfinance was the establishment of Self-Employed Women's Association (SEWA) in Gujarat. SEWA was registered as a trade union of self-employed women workers of the unorganized sector in 1972. This trade union established their bank known as SEWA Bank in 1974. To establish this bank four thousand union members contributed Rs.10 each as share capital. Since then this bank is registered as a co-operative bank and has been providing banking services to poor women and has also become a viable financial venture. The first major effort to reach these rural poor was made by NABARD in 1986-87, when it supported and funded an action research project on 'saving and Credit Management of Self-Help Groups' of Mysore Resettlement and Development Authority (MYRADA). For this purpose, a grant of Rs. one million was provided to MYRADA. The encouraging results were yielded. In 1988-89, NABARD undertook a survey of 43 NGOs spread over eleven states in India to study the functioning of the SHGs and possibilities of collaboration between the banks and SHGs in the mobilization of rural savings and improving the credit delivery to the poor. In order to meet their credit requirements, in July 1991 RBI issued a circular to the commercial banks to extend credit to the SHGs formed under the pilot project of NABARD. The programme acquired a national priority

from 1999 through Government of India budget announcements. Since the time of its origin, NABARD provides policy guidance, technical and promotional support mainly for capacity building of NGOs and SHGs. These days many public and private commercial banks, regional-rural banks, co-operative banks, co-operative societies, registered and unregistered NBFCs, societies, trusts and NGOs are providing microfinance by using their branch network and through different microfinance delivery model.

DELIVERY MODELS OF MICROFINANCE

The concept of microfinance involves informal and flexible approach to the credit needs of the poor. There is no single approach or model that fits in all the circumstances. Therefore, a number of microfinance models emerged in different countries/states according to the suitability to their local conditions. Broadly, the microfinance delivery methods can be classified into six groups as follows:

- **Grameen Bank Model:** Grameen Bank model is one of the oldest and most successful models of microfinance. This model was developed in Bangladesh. In this model microfinance programme participants are organized into groups of five members. They make mandatory contribution to group savings and insurance fund. Each member maintains her individual saving and loan account with the bank and after contributing to the savings fund for a fixed time the group members receive individual loans from the bank. But the group is not required to give any guarantee for the loan repayment by its member. Repayment responsibility solely rests on the individual borrower and there is no form of joint liability, i.e. group members are not responsible to pay on behalf of a defaulting member. Loans are provided for six months to one year duration.
- **Individual Lending Model:** In this method, individuals can get loans without any membership of a group. This is a straightforward credit lending model in which micro-loans are given directly to the borrowers. In this model, the financial institutions have to make frequent and close contact with individual clients to provide credit products customized to the specific needs of the individual. It is most successful for larger, urban-based, production-oriented businesses. The model is followed by many financial institutions like the Association for the Development of Micro-Enterprises (ADEMI) in Dominican Republic, Bank Rakyat Indonesia, Senegal Egypt, Self-Employment Women's Association in India, etc.
- **The Group Approach:** The group approach delegates the entire financial process to the group rather than to the financial institutions. All financial activities like savings, getting loans, repayment of loans and record keeping are managed at the group level. In this method, 10-20 members are organized to form a group. These group members make regular savings of fixed amount in a common fund. The amount and frequency of savings is mutually decided by the group members. The financial institutions issue loan in the name of group and whole group is considered responsible for repayment. The amount of loan depends upon the total accumulated amount of saving of the group. Group members themselves decide about the criteria of dividing the loan among the group members
- **Village Banking Model:** This village banking model is an expansion of the group approach. This model was developed in Bolivia during mid-1980s by the Foundation for International Community Assistance (FINCA), a non-profit microfinance organization. In this model, a Village Bank is developed by grouping 30 to 100 low-income individuals who seek to improve their lives through self-employment activities. Members themselves run the village bank, they choose their members, elect their own officers, establish their own by-laws, distribute loans to individuals and collect savings and payments. Loans are repaid weekly in small installments. Thus, village banks have a high degree of democratic control and independence. A credit union is a democratic, not-for-profit financial co-operative.

MICROFINANCE INSTITUTIONS

Microfinance institutions (MFIs) are the organizations or associations of individuals that provide financial services to the poor. In India, there is a wide range of such organizations with diverse legal forms, varying significantly in size, outreach, mission and credit delivery methodologies. Fig.1.1 represents the hierarchy of financial institutions for the microfinance disbursement.

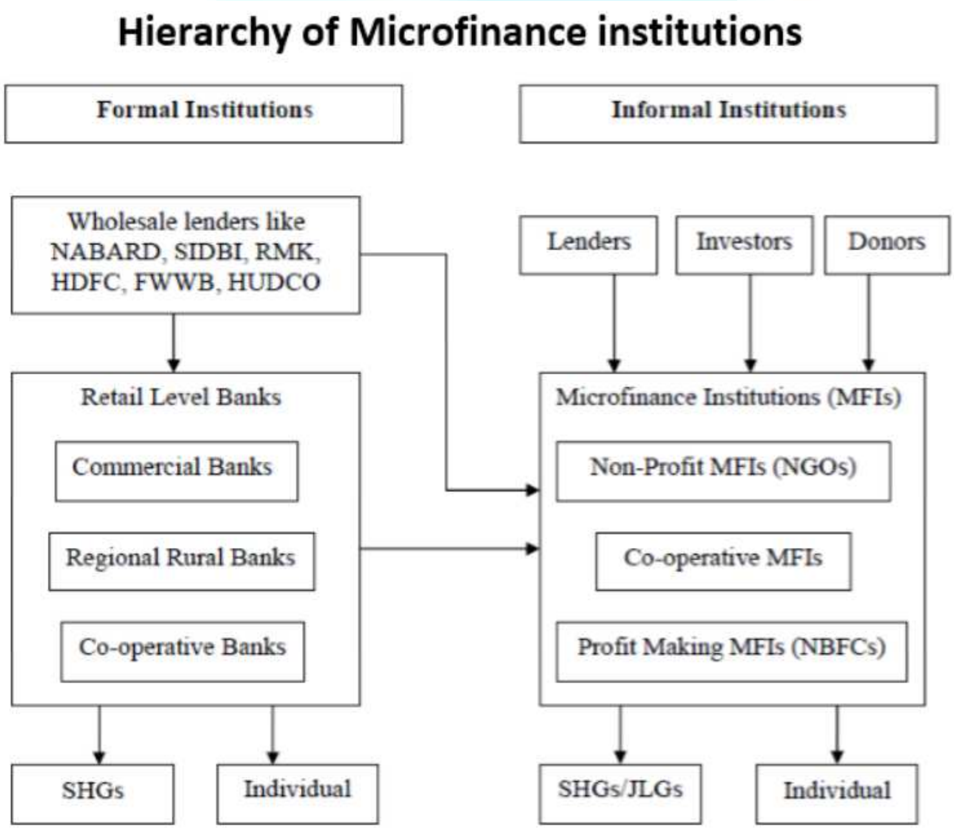

Fig. 1.1

Following the guidelines of RBI all scheduled commercial banks including RRBs give bulk loans (classified as a priority sector) to MFIs for on-lending to groups and other small borrowers. At present, both public and private banks are extending considerable loans to MFIs at interest rate ranging from 8 to 11 per cent per annum.

Top Banks Microfinancing Institutions operating in India as per Sa-dhan report in March 2014 (Fig. 1.2)

FIG. 1.2

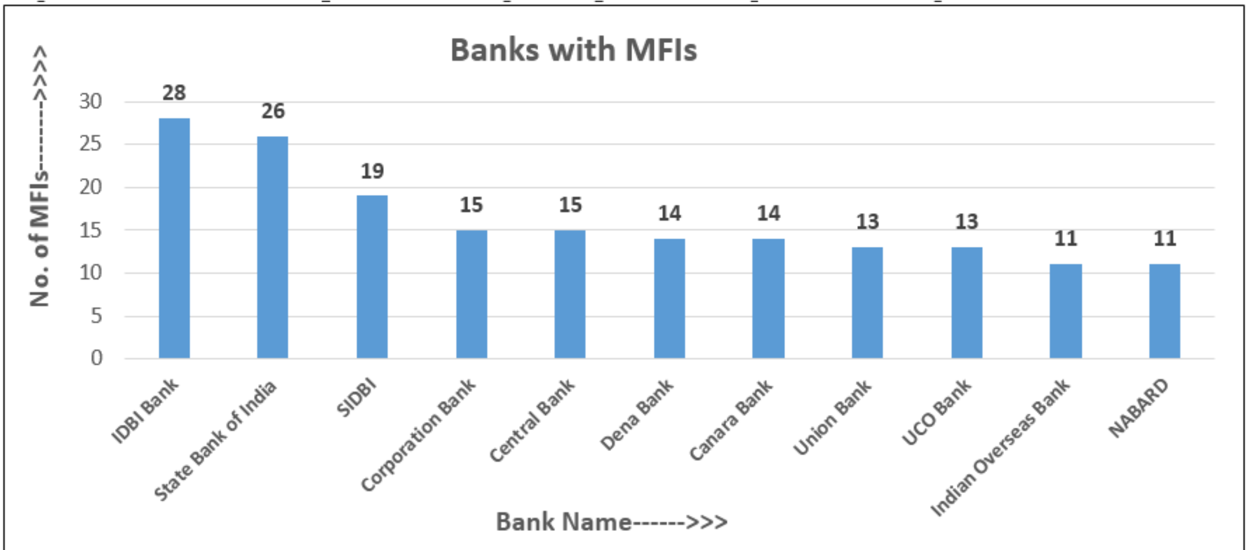

Fig. 1.2

DISBURSEMENT OF MICROFINANCE IN INDIA

The Indian Microfinance Sector has witnessed a phenomenal growth over the past 15 years. The number of Institutions providing microfinance services has gone up from a few to several hundreds. The quantum of credit made available to the poor and financially excluded clients have gone past `33,500 crore and number of clients benefitted crossed 33 million as of March 2014. The SHG bank linkage program has equally grown to touch the lives of individuals through SHGs with an outstanding loan portfolio of approx. 43,000 crores.

LOAN DISBURSEMENT-REGIONAL PATTERN

The year 2013-14 has experienced a remarkable growth in MFI loan disbursement in all regions. Among all regions, the Eastern and Southern regions have the largest shares of loan disbursements (31% and 28% respectively); the same trend was followed in year 2012-13 also. Refer Fig. 1.3.

FIG. 1.3

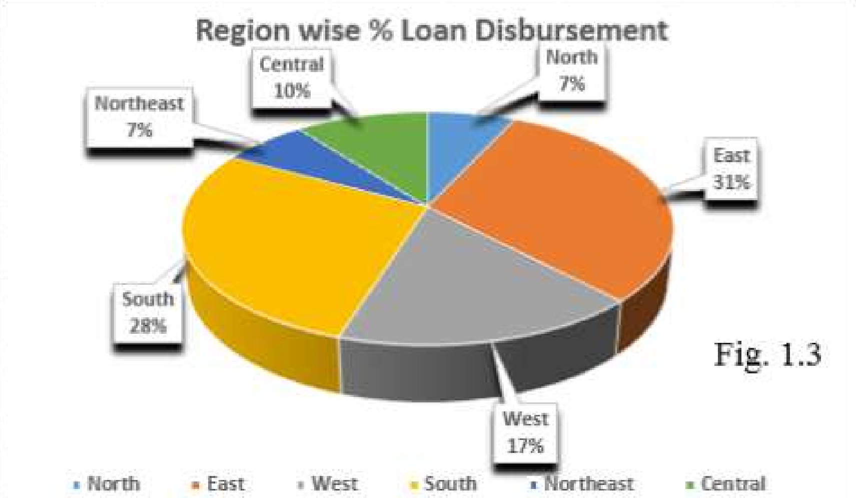

Fig. 1.3

PURPOSE OF LOAN

Traditionally, MFIs have been lending for both consumption and productive purposes. It is believed that poor people use their loans for their emergency and consumption needs more than for livelihoods. In 2011, RBI regulation stipulated that a minimum of 70% of the MFI loans are to be deployed for income generating activities. Analysis of the loan portfolio held by reporting MFIs for 2013-14 shows that the proportion of income generation loan to non-income generation loan is 80:20. Non-income generation loans are used for consumption, housing, education, water & sanitation, health etc.

CHALLENGES FACED BY MFIs IN INDIA

No doubt, microfinance programme has shown impressive achievements, but there are lot of challenges associated with MFIs currently working in India. Some of the challenges are compiled in below bullets.

- **Regional Disparity**: It has been observed that the microfinance programme is mainly run by formal financial institutions with the help of SHGs. As a result, microfinance programme is progressing in those areas of the country where there is tremendous growth of formal financial institutions. Actually, many big MFIs are activating in those states where the banking network is very strong. In the southern states, such as Andhra Pradesh, Tamil Nadu, Karnataka and Kerala, the spread of SHG bank linkage programme as well as the MFI programme is very large. But the north and north-eastern region is almost neglected approximately 50 per cent of the total microfinance programme beneficiaries belong to these four south Indian states.
- **Deserving Poor are Still not Reached**: The microfinance delivery models are not exclusively focused on those who are below the poverty line or very poor. Though the programme is spreading rapidly but with a slow progress in targeting the bottom poor households. About 50 per cent of SHG members and only 30 per cent of MFI members are estimated to be below the poverty line. According to Ghate (2008), approximately 75 million households in India are poor and about 22 per cent of these poor households (i.e. 16.5 million) are currently receiving microfinance services. The present study also shows that just

19 per cent of the programme participants were BPL at the time of joining microfinance programme. Therefore, it can be said that substantial groups of poor population have been excluded from availing the benefits of the programme

- **High Interest Rates:** Affordability of loan is equally important to the access of financial services to the poor. Economic fundamentals exhort that every borrower is interest sensitive and the capacity of borrowing decreases with increase in interest rates. High interest rates may prove to be counterproductive, and weaken the social and economic condition of poor clients. Normally, banking sector is charging 9 to 10 per cent interest rate per annum from the SHG members, while MFIs charge comparatively higher interest rate which is generally 11 to 24 per cent per annum.
- **Use of Loans-** Practitioners and donors from the charitable side of microfinance frequently argue for restricting micro credit to loans for productive purposes–such as to start or expand a micro enterprise. Those from the private-sector side respond that because money is fungible, such a restriction is impossible to enforce, and that in any case it should not be up to rich people to determine how poor people use their money.
- **Uneven Growth of Scheme:** An approach to provide credit to the agriculture sector, including small farmers, is the Kisan Credit Card (KCC), offered by commercial banks, RRBs and cooperative banks. Since their introduction in 1998-99.Though these are not truly credit cards, the KCCs present a number of advantages for the borrowers and lenders. But one concern is the uneven growth in the distribution of the KCC scheme
- **Lack of Insurance Services:** Poor people are vulnerable to financial shocks. A small change in their earning patterns due to natural calamities, health problems, death of earning member etc. can push them to destitute. So, a provision of insurance under the microfinance programme is very essential to help the poor to cross the poverty line. But, in reality, the current microfinance programme in India is just focused on regular saving and micro-credit. SHG-BLP developed by NABARD is also providing saving and credit services mainly and the provision of insurance is very less. A research report by Invest India Market Solutions Pvt. Ltd. (IIMS, 2007) indicates that the penetration of life insurance is only 12 per cent among the rural poor and 19 per cent among the urban low-income population. So, in India the provision of insurance services is at the initial stage and this integral part of the microfinance programme is still neglected.

UNREGULATED MICROFINANCE INSTITUTIONS

In India, micro finance is provided by a variety of institutions. These include banks (including commercial banks, RRBs and co-operative banks), primary agricultural credit societies and MFIs that include NBFCs, Section-25 companies, trusts and societies. But only the banks and NBFCs fall under the regulatory purview of the Reserve Bank of India. Other entities, e.g., MFIs are covered in varying degrees of regulation under their respective State legislations. There is no single regulator for this sector. As a result, MFIs are not required to follow some standard rules and are not subject to minimum capital requirements and prudential norms.

SUGGESTIONS

Based on this study and analysis of challenges faced by MFIs in India, here are some of the suggestions which can help in improving the situation of these institutions so that these MFIs can also actively support the government's intension of poverty alleviation and accelerate their growth.

- Reducing Regional Disparity: As discussed in the problems, the spread of microfinance programme is unequal among various regions of India and there is limited spread in the poorer states. So, there is ample scope to spread microfinance programme in the unreached areas including the poorer states. These poor states are Assam, Bihar, Jharkhand, Gujarat, Himachal Pradesh, Maharashtra, Madhya Pradesh, Chhattisgarh, Orissa, Rajasthan, Uttar Pradesh, Uttaranchal and West Bengal. These states accounted for 70 per cent of India's poor and were not effectively reached by the microfinance programme.
- Technology to reduce Operating Cost: MFIs should use new technologies and IT tools & applications to reduce their operating costs. Though most NBFCs are adopting such cost cutting measures, which is clearly evident from the low cost per unit money lent (9%-10%) of such institutions. NGOs and Section 25 companies are having a very high value of cost per unit money lent i.e. 15-35 percent and hence such institutions should be encouraged to adopt cost-cutting measures to reduce their operating costs. Also initiatives like development of common MIS and other software for all MFIs can be taken to make the operation more transparent and efficient.
- Schemes to Support MFIs: MFIs are meant to play an important role in reaching the poor people who are not served by the formal financial institutions. But most of these institutions are restricted by 97 RBI to collect savings from their members and raise public funds. As these institutions do not publish their annual financial reports, it is difficult to determine their financial health. Therefore, the formal financial institutions also hesitate to provide loans to these institutions. To tackle this problem, some schemes may be adopted to provide support and help for MFIs.
- Insurance Services: In India, the penetration of insurance services among rural poor people is very limited and there is a great potential for the same. Moreover, poor are very much vulnerable to the natural uncertainties and insurance is necessary for them. The network used for microfinance programme can be used to tap the potential of insurance in rural markets. Non-Government Organizations, Microfinance Institutions and Self-Help Groups can be used as micro-insurance agents. They can offer target specific insurance products at a relatively lower cost, for a lower coverage of amount. It may be envisaged that micro-insurance would facilitate penetration of insurance to rural and remote areas. However, some of the NGOs are providing accident, life and crop insurances in India but such type of services need to be expanded.
- Securitization of Loans: This refers to a transaction in which the repayments from a set of microloans from one or more MFIs are packaged into a special purpose vehicle, from which tradable securities are issued. As the loans from multiple MFIs can be pooled together the risk gets diversified. Though securitization of loans and portfolio buyout are similar in many ways like first loss default guarantee clause, limit to the amount of loans that can be sold off etc. The major difference between the two is that securitizations require a rating from a credit rating agency and that it can be re-sold, which makes securitized loans attract more potential buyers.

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