

## MICROFINANCING: A BIRD'S EYE VIEW

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### ABSTRACT

*This paper deals with Micro financing which is a general term to describe financial services to low-income individuals or to those who do not have access to typical banking services. Microfinance is also the idea that low-income individuals are capable of lifting themselves out of poverty if given access to financial services. Micro financing helps in achieving sustainable development. In order to attain sustainable rural development and progressive poverty alleviation, the role of Micro financing agencies becomes very important in the context of current scenario. Microfinance has grown rapidly both in terms of outreach and also in the terms of number of service providers. Though, there are enough constrains in its way to become all-encompassing solution to mitigate the problem of credit for the financially disempowered groups.*

**Keywords:** Institutional capacity building (ICB), Microfinance organizations (MFO), Microcredit , MicroFinance Institutions (MFIs), MoRD, NGO , Non-Banking Financial Companies(NBFC),Self-Help Group (SHG) , Swarna Jayanti Grama Swarojgar Yojana SGSY.

### INTRODUCTION

Microfinance is defined as, financial services such as Saving A/c, Insurance Fund & credit provided to poor & low income clients so as to help them to rise their income & there by improve their standard of living. 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 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’. Due to the broad range of microfinance services, it is difficult to assess impact, and very few studies have tried to study its full impact.

### Features of Microfinancing:

1. Loan are given without security;
2. Loans to those people who belong to BPL (*Below Poverty Line*);
3. Even members of the SHG enjoy microfinance;
4. Maximum limit of loan under microfinance is Rs.25,000/-;
5. The terms and conditions given to poor people are decided by the administering NGOs;

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Microfinance works by providing small loans to the poor who otherwise have no access to traditional means of credit in order to start or expand the business they are already doing so as to generate income for better lives for themselves. The loans are repaid to MicroFinance Institutions (MFIs) without any collateral security or resorting to coercion. It gives the village more freedom to regulate itself.

Microfinance facilities are provided by both public sector and private sector institutions, which are known as formal and informal institutions. Apex Development Financial Institutions, Commercial Banks, Regional Rural Banks and Cooperative Banks are formal micro-financing institutions. These institutions provide the micro financing facility in addition to their main activity, i.e. general banking activities. In other words, the private sector institutions, whose main activity is microfinancing, are referred to as MFIs.

Microcredit is the part of Microfinance. It is a movement which has since been in existence in India for a long time in the form of informal banking. Money lending is one of the microcredit systems. This is generally seen among the rural folk who basically do not have education and are, thus, denied the facility of formal system of banking.

Microcredit requires to be supported by savings, risk reduction measures, insurance etc., which comprises Microfinance. Microcredit originated in the context of the strategy for poverty mitigation. It was meant for the poor and hence the word *Micro* was chosen to indicate its target population - the poor - who now would have the opportunity to access small loans (to suit their absorption capacity), quickly and at low cost. Hence microcredit interventions were embedded in the development strategy adopted by the interveners- usually the NGO. In this context, it often took on a broader set of interventions than even the portfolio of microfinance. This broader portfolio of interventions included those i) to reduce risk; ii) to create a portfolio of livelihood investment options which the poor are able to select from to build their family livelihood strategy which comprises many activities managed by the whole family. These options need to be created by investment in all round development which has to come from the Government, Private sector or NGOs especially in remote areas.

Therefore, when Microcredit is placed within the framework of a development strategy, it includes not just microfinance but goes beyond to include investment in all round development to reduce risk, to build market linkages and infrastructure for storage and communication, to add value and scale, to diversify off and on farm produce and to introduce off farm skills. To reduce this holistic strategy to “micro credit provision” is to castrate it and to separate it completely from its development roots. The neo liberal approach thrives on the presumption that capitalism is the only system possible; and it proceeded to strip the finance sector of all controls and regulation – resulting in a greedy capitalism that was free of ethics and under no obligation to society or the environment. The microfinance approach helps to mitigate the vulnerable populace from the vagaries of greedy capitalism.

The micro credit facility has flourished to the extent it exists now is because the institutions have concentrated on women folk in the rural areas. It is felt that men are restless, ambitious and compulsively mobile. They want to learn the skill and go to cities for better living. However, women do not wish to leave their village. Thus, the system had become successful because there is more of women involvement in the scheme than men.

The change of the woman from a lowly paid salaried class to an enterprising businesswoman is what the kind of transformation micro credit can enable in the lives of people. When the micro credit is properly managed, it helps to improve the income of people irrespective of the activity they are in. Microcredit schemes are vital and necessary among the poor populace, who have no access to formal banking.

It is widely accepted that the concept of microfinancing is essential both for the development of rural area and also for social upliftment of the rural poor. This has been realized world over and microfinancing policies have been brought in for achieving sustainable development. Even many renowned economists have published the importance of microfinancing and its role in the development of rural area. Number of under-developed countries, have felt the need for micro financing for the growth of its rural areas and the same could be seen even in emerging economy like India.

The credit for the success of the microfinancing system should go to well-intending Non-Governmental Organisations (NGOs). The success of the self-help groups (SHGs) has also played their part in the role played by the NGOs in microfinancing.

The concept and role of microfinancing is well known for social upliftment as well as for the development of rural and backward areas. Considerable efforts are being made at the public and private sectors to bring in enough number of technologies in the rural areas for their implementation and use through microfinancing for the overall development. However, support of microfinancing agencies including banks is not reaching at the grass root levels and, therefore, most

of the developmental programmes get diluted or ineffective and many a times they don't even take off. In the rural areas, people are not much aware about the microfinancing schemes and their benefits. Hence, in order to attain sustainable rural development and progressive poverty alleviation, the role of microfinancing agencies becomes very important in the context of current scenario. In the present paper, the whole mechanism of microfinance, its role to achieve sustainable rural development and for social economic benefits, are discussed in detail.

### **Wedding Microfinance into Credit Plans**

There are currently three major programs and a few minor ones, which have incorporated micro credit in their strategy. The three major ones are i) the SHG-Bank Linkage program with no subsidy for the asset provided to the recipient, but with provision for investment in institutional capacity building (ICB) of the Self Help Group; ii) The Swarna Jayanti Grama Swarojgar Yojana (SGSY) of the Ministry of Rural Development (MoRD) with a subsidy for the assets and provision for ICB which was not used for the purpose intended but to fund large gatherings addressed by politicians or given to institutions with no experience in ICB and iii) the NBFC/MFI group of institutions; this group is crystallising into two: those with neo-liberal features and the other with a development mission.; and iv) The minor schemes providing micro credit are several programs involving credit and/or subsidy of the Ministry of Women and Child Development, Rashtriya Mahila Kosh etc.

No wonder microcredit today has wide appeal among policy makers as it soothes the conscience of those in power and who provide the funds, it fills the pockets of those managing it and is rewarded with the highest recognitions; besides it has helped to fill the gap created by "tired donors" who need a new recipe; hence it is attractive even in the development oriented institutions. Myrada that started in the year 1968 and now directly managing 18 projects in 20 backward and drought prone districts of Karnataka, Tamil Nadu and Andhra Pradesh extending microcredit facility, receives dozens of applications from students to study its micro credit interventions but none for watershed management in which Myrada extends the facility.

Microfinance has grown rapidly both in terms of outreach and also in the terms of number of service providers. The sector is diverse with the presence of different players of varying sizes and forms. Usually many service providers called NGO-MFOs go unnoticed because of their geographical locations and limited outreach. Some of the larger MFOs are transforming into regulated institutions and are, therefore, in a position to attract capital from both the private investors and the formal banking system. At the same time, at the other end of the spectrum is the smaller NGO – MFOs team ups. Their outreach and capacities is not much known and, therefore, they are not in a position to attract capital. Thus, the absence of concrete data-base in this regard comes in the way of the orderly growth of NGO-MFOs which could lead to better financial inclusion.

Another entity that has taken lead in extending the microcredit is NABARD. The NABARD-GTZ Rural Finance Program engaged the services of APMAS to compile a comprehensive information-base with a view to understand the specific requirements of the smaller organizations. The outreach of these organizations may be insignificant, given the size of the country, but their role is crucial and important as they are providing a valuable service to the excluded population.

Since the last two decades, NGOs have been offering financial services to clients in a limited manner. The success of the SHG -Bank linkage program brought NGOs to the forefront and in a way recognized their efforts, some of whom were engaged in financial intermediation. Since in the non-formal sector, the microfinance efforts were led by the NGOs, microfinance was taken up in a developmental mode rather than as a commercial financial intermediation activity. Also important is the fact that NGOs are formed with a voluntary spirit and profit making is not a motive for sustaining such institutions. As the NGOs grow over a period of time, they realize the limitations of their structure and look for alternate forms of organizations in order to continue providing financial services on a more sustainable basis to the needy. Some of the erstwhile NGO-MFOs have been successful in transforming themselves into organizational forms more suited for financial intermediation, which are normally the companies. As a result, microfinance institutions (MFIs) in India can now be found in the form of profit non-banking financial companies (NBFCs) as well as not for profit companies.

### **Overview and main characteristics of MFOs**

The microfinance sector in India consists of approximately 800 Microfinance Organizations (MFOs) of different nature and size. There is a high geographic concentration with 75% of MFOs in two states only: Andhra Pradesh 62% and Tamil Nadu 13%, while the remaining 25% are scattered over 11 states. Incidentally the states with a high concentration

of MFOs also have a high concentration of SHGs and substantial credit linkages of these SHGs to the banks. The southern states are also states with a high banking density. Bihar with 44 MFOs is third in the states with large presence of MFOs.

The MFO sector is highly atomized and decentralized : 95% of MFOs operate in only one state. Only 36 MFOs operate in more than one state. Only one MFO has a truly wider presence in most of the less developed states in the country, but also in the southern states. MFOs which have a pan- India presence are necessarily registered as NBFCs and one hardly sees NGO-MFOs operating in more than one state. There was one NGO-MFO registered as a Society in Andhra Pradesh which had ambitions to spread to other states in the late 90s, but it could not realize its dreams partly due to its business model.

### **Organization of MFOs by legal types**

There are a variety of financial institutions of diverse legal forms providing microfinance services in India. According to the *Task Force Report on Supportive Policy and Regulatory Framework for Microfinance* by NABARD, the MFOs can broadly be sub-divided into three categories of organizational forms: 'Not for Profit MFOs' or 'NGO-MFOs' – Societies, Trusts and 'Not for Profit Companies'; 'Mutual Benefit MFOs' - generally in the cooperative sector comprising State Credit Cooperatives, National Credit Cooperatives and Mutually Aided Cooperative Societies (MACS). The third category is 'for Profit MFOs' which would cover Non-Banking Financial Companies (NBFCs) registered under the Companies Act, 1956.

Based on the above definition and the legal type of organizations, MFOs can be categorized into three main types: companies, NGO MFOs and mutual benefit MFOs. These three types are distinctly different in many aspects.

### **Delivery methodology of the MFOs**

MFOs deliver financial services through different lending technologies. The popular lending technologies/ methodologies among the MFOs are the SHG, Grameen, Individual and Cluster. Rural microfinance clients are both poorer on an average than urban clients and urban clients advance out of poverty at a relatively faster rate according to a Report of the Grameen Foundation.

The impact of microfinance on the poor has been tremendous; helping to empower individuals economically, socially and politically. It is reported that nearly 9 million Indian households, including approximately 45 million family members, rose above the World Bank's \$1.25 a day poverty threshold between 1990 and 2010. According to a 2008 Report of the World Bank, 10% of the \$60 million demand for such services had been met in India alone.

A study conducted by the SIDBI, showed that the borrowers benefitted significantly from microfinance. The report mentions that 76% were able to increase their income, 66% improved their food consumption, 56% improved their housing conditions, and 77% had better educational facilities.

But, the Indian MFIs forget that it is not only money lending which would improve the living standard of the poor but emphasis should also be placed on developing the skills, education and ability to create productive assets for steady income flows.

Microfinancing is only a part of the prosperity rosary. The rosary includes other beads like imparting of skills, providing financial literacy, creating markets, providing insurance and managing risks. These together with microfinancing would not only help the poor manage the loans properly and repay the dues, but also make the MFIs successful and more relevant.

However, there were allegations in the past, particularly in Andhra Pradesh, where the MFIs are very successful, that they use excessive pressure to enforce payments, charge higher rates of interest, etc. Moreover, even the suicides in some villages were linked to the alleged pressures of MFIs. This led to the realization by the government that regulations were required and guidelines were issued through the RBI. It has put certain limitations on the activities of the MFIs and gave more security to borrowers, like maximum loan sizes and interest rates, recognizing the importance of financial inclusion for all and role of the MFIs in realizing this goal. However, the government of Andhra Pradesh has introduced separate legislation requiring MFIs to get approval of the government agency, before each new loan application is processed for disbursement. This has adversely affected the borrowers which has resulted in larger MFIs to write off debt running in millions and left many smaller players bankrupt impacting the poor further and forcing them to go back to the clutches of traditional money lenders.

Muhammad Yunus, the father of modern day microfinance movement stated, “*We never said microfinance was a silver bullet*,”. Microfinance is neither perfect solution, nor it is immune to malpractice. It is, however, unrealistic that while dealing with millions of customers, each and every customer can be satisfied to the fullest. Microfinancing should only be seen as one among manifold solutions for poverty alleviation and rural development.

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