PROBLEMS OF MICROFINANCE IN INDIA

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ABSTRACT

The purpose of this study is to analyse and to understand the Microfinance in India as a powerful tool for poverty alleviation and growth and development of poor people. India is a country which has the highest number of households which are excluded from banking. In our country many of the poor households still do not have access to basic financial services such as savings, credit and remittances and such financial exclusion faced by such people results in discrimination and denial of equal opportunities to them. The prospect of Micro-Finance is dominated by Self Help Groups (SHGs) and its main aim is to provide financial services to the poor people. The Micro Finance Institutions (Development and Regulation) Bill, 2012 has passed on 11 February, 2014to provide a statutory framework for the promotion, development, regulation and orderly growth of such Micro Finance Institutions (MFIs) and thereby facilitate financial inclusion.

This paper discusses the conceptual framework of microfinance in India, types of microfinance institutions, benefits extended by MFIs, ills of micro finance institutes, and future prospects of MFIs.

KEYWORDS: Growth and development, Micro finance, Micro finance institutions.

OBJECTIVES OF THE STUDY

1. The main objective of the study is to identify the main problems prevailing in microfinance in India.
2. The other objective of this study is to find out the solution of the problems faced by MFIs.

RESEARCH METHODOLOGY

This is an exploratory research paper based on secondary data. Data have been collected through various books, publications, reports and websites.

INTRODUCTION

Microfinance is a source of financial services for low-income people, consumers, self-employed, and small businesses lacking access to banking and related services. 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.

According to the United Nations, microfinance institutions can be broadly defined as provider of small-scale financial services such as savings, credit and other basic financial services to poor and low-income people. 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.

Main characteristics of Microfinance are:

1. Borrowers are the low income people mostly from rural areas.
2. Micro loans.
3. Loans are for shorter period.
4. Loans are offered without any security or collaterals.
5. High frequency of repayment.
6. Loans are given to clients for income generation purposes.

HISTORICAL BACKGROUND OF MICROFINANCE IN INDIA

Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women's Association ("SEWA") of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganised sector in Ahmedabad City, Gujarat. The microfinance sector went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. From humble beginnings, the sector has grown significantly over the years to become a multi-billion dollar industry, with bodies such as the Small Industries Development

Bank of India and the National Bank for Agriculture and Rural Development devoting significant financial resources to microfinance.

MICRO FINANCE INSTITUTIONS

Micro finance institutions are those institutions which have microfinance as their main operation or business. Many organizations with varied size and legal forms offer microfinance services. These institutions lend through the concept of Joint Liability Group (JLG). A Joint Liability Group is an informal group comprising of 8 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.
MFIs may be classified as follows:

Not-for-profit MFIs:

- Societies (such as Bandhan, Rashtriya Seva Samithi, and Gram Utthan).
- Public trusts (such as Shri Kshetra Dharmasthala Rural Development Project, and Community Development Centre).
- Non-profit companies (such as Indian Association for Savings and Credit, and Cashpor Micro Credit).

Mutual benefit MFIs:

- Co-operatives registered under State or National Acts (such as Pustikar Laghu Vyaparik Pratisthan Bachat and Sakh Sahkari Samiti Limited)
- Mutually-aided co-operative societies (MACS; such as Sewa Mutually Aided Cooperative Thrift Societies Federation Ltd).

For-profit MFIs:

- Non-banking financial companies (NBFCs; such as Bhartiya Samruddhi Finance Ltd, Share Microfin Ltd,
  SKS Microfinance Ltd and Spandana Sphoorthy Financials Ltd)
- Producer companies (such as Sri Vijaya Visakha Milk Producers Co Ltd)
- Local area banks (the only such MFI is Krishna Bhima Samruddhi Local Area Bank).

Sl. No.	Type of MFI	Number	Legal Registration
Not-for Profit MFIs			
1	NGOs	400-500	Society Registration Act, 1860 Indian Trust Act, 1882
2	Non-Profit companies	20	Section-25 of Indian Companies Act, 1956
Mutual Benefit MFIs			
3	Mutual benefit MFIs – Mutually Aided Cooperative Societies (MACS)	200-250	Mutually Aided Co-operative societies, Act enacted by State Governments
For Profit MFIs			
4	Non-Banking Financial Companies (NBFCs)	45	Indian companies Act, 1956 Reserve Bank of India Act, 1934

Source: NABARD ISSUES RELATED TO MICROFINANCE

MODELS OF MICROFINANCE

Self Help Group Model: A Self Help Group (SHG) is a small group of 10 to 20 persons of rural poor who come together to mutually contributed common fund for meeting their emergency needs. SHG - Bank Linkage Programme was introduced by NABARD in 1992. Under this programme three different models have emerged:-

a) Model I: - SHGs promoted, guided and financed by banks.

b) Model II:- SHGs promoted by NGOs / government agencies and financed by banks.

c) Model III:- SHGs promoted by NGOs and financed by banks under NGOs / formal agencies as financial intermediaries.

Regional share in linkages—SHGs with outstanding loans:

	2009		2010		2011		2012	
	Groups	% Share	Groups	% Share	Groups	% Share	Groups	% Share
Northern	166,511	3.9	158,829	3.9	151,260	3.1	212,041	4.9
Northeastern	117,812	2.8	85,276	2.8	151,280	3.1	159,541	3.7
Eastern	933,489	22.1	985,094	22.1	1,171,840	24.3	985,329	22.6
Central	332,116	7.9	497,340	7.9	361,822	7.5	352,452	8.1
Western	393,499	9.3	439,199	9.3	313,913	6.5	289,472	6.6
Southern	2,280,911	54	2,421,440	54	2,663,569	55.3	2,355,732	54.1
All	4,224,338	100	2,165,738	100	4,813,684	100	4,354,567	100

Source: NABARD Provisional data.

Federated Self Help Group Model: The Federated Self Help Group model is one such way to scale up the previous model. Federation of SHGs bring together several SHGs. Compared to a single SHG, federation of SHGs have more than 1000 members .In Federated SHG model, there is a three tier structure the basic unit is the SHG, the middle tier is a cluster and the topmost unit is an apex body, which represents the entire SHG. At the cluster level, each SHG is represented by two of its members. The representatives of each SHG meet regularly. With the help of federations, an NGO with limited resources can have an impact on a large number of people. Few notable examples of Federated Self Help Group model are PRADAN, Chaitanya and SEWA.

Regional spread of SHG federations in India in 2007 and 2012:

	No. of primary federations		No. of secondary federations		No. of tertiary federations		Total	
Region	2007	2012	2007	2012	2007	2012	2007	2012
Northern	126	371	21	24	–	14	147	409
North Eastern	122	369	10	18	–	0	132	387
Eastern	5,745	62,189	105	2,940	–	56	5,852	65,185
Central	487	5,459	334	180	–	2	821	5,641
Western	663	8,629	1	11	–	1	664	8,641
Southern	59,172	83,268	2,093	3,185	22	25	61,287	86,478
Union Territories	–	1	–	0	–	0	–	1
All India	66,310	160,286	2,571	6,358	22	98	68,903	166,742

Source: APMAS Hyderabad.

Grameen Bank Model: The Grameen Bank model has been a case of exceptional success in Bangladesh. It turns out that many organizations in India have adopted Grameen Bank model with little variations and good. Some of the significant features of Grameen bank model are low transaction costs, no collateral (peer pressure is sufficient), repayment of loans in small and short interval and quick loan sanctions with little or no paper works and no formalities. Repayment of loans in small chunk is one of the major reasons of high loan recovery rate of a Grameen Bank. Furthermore, loans are provided for all purposes like housing loans, sanitation loans, supplementary loans etc.

Co-Operative Model: A co-operative is an organization owned by the members who use its services. This model works on the principle that every community has enough human and financial resources to manage their own financial institutions. The members who own it are the members who use its services and can come from different sections of same community like agriculture, retail, wholesale etc. By proper networking small scale local institutions scale up and become sustainable while locals maintain ownership and control over their institution.

THE MICRO FINANCE BILLS 2007 Vs 2012

A comparative table indicating key differences between the Micro Financial Sector (Development and Regulation) Bill, 2007 and the Micro Finance Institutions (Development and Regulation) Bill, 2012 is given below:-

Aspects	Micro Financial Sector (Development and Regulation) Bill 2007	Micro Finance Institutions(Development and Regulation) Bill 2012
Scope and application	Only NGO-MFIs registered as societies, trust and cooperatives (i.e. excluding NBFCs and Section 25 companies)	All MFIs in all forms
Structure of the sector	One tier, MFOs only, (apart from NBFCs and Section 25 companies, but no provisions applicable to them)	The sector is now covered Under the provisions of the Bill in its entirety.
Savings mobilization	Only thrift‗ for MFO from members	Thrift mobilization from public also permitted
Supervisor	NABARD	RBI – with powers to delegate to NABARD and to other agencies as may be deemed fit.
Advisory council	Advisory, with majority consisting of officials representing specified	In addition to a national level council, provisions have been made for state level councils

	agencies ex-officio.	as well as district level committees for monitoring of functioning of MFIs
Grievances handling and appellate authority	MFDC may set up ombudsman	Ombudsman provided for
Capital norms	NOF of at least Rs.5 lakh and a capital adequacy ratio of 15%	Rs.5 lakh as minimum entry capital – RBI to stipulate prudential norms
Instruments	Registration for thrift taking MFOs and information reporting for all	Registration for all, information reporting and interest rate caps
Customer protection	Through Ombudsman	Norms for customer selection, size of loans, interest disclosure, process controls and interest / margin ceilings.
Powers of regulator	Minimal	Power to cancel registration, order for winding up, merger and acquisition, imposition of penalties, delegation of powers, issuance of directions

ROLE OF NABARD IN MICROFINANCING

NABARD is doing exceptionally well through farm and non-farm lending for rural areas so that the productivity of the persons could be increased and take them out of vicious cycle of poverty. Research and Development (R & D) Fund was set up since inception by NABARD to provide financial support for conducting in-depth studies, promoting applied research and technology based innovations. It also aimed at training and skill up gradation of personnel of client institutions and dissemination of research findings.

NABARD continued to play the role of a facilitator in scaling-up the micro-finance programme. Various training programmes are conducted for SHG/NGO/Bank officials.

NABARD has been extending various supports to various stakeholders to facilitate sustained access to financial services for the unreached poor in rural areas through various microfinance innovations in a sustainable manner. NABARD continued its refinancing and promotional role to support stakeholders including banks. During the year 2011–12, refinance of `30.73 billion was provided to banks covering their lending to SHGs.

NABARD support to SHPIs and their performance:

Sanctions during the year 2011–12				Total groups formed so far
Agency	No.	Amount (₹ million)	No. of Groups	
DCCB	7	11.85	4,740	71,695
RRB	3	9.68	3,810	53,145
NGO	166	357.38	85,571	499,909
FC	4	0.07	61	7,689
IRV	1	0.52	300	43,223
Total	181	379.50	94,482	675,661

Source: Provisional Data from NABARD Head Office Mumbai.

NABARD continued with its initiative of promoting Joint Liability Groups (JLGs) with a view to promoting access to credit for small and marginal farmers and tenant cultivators. The JLGs fill a critical gap in the rural areas where marginal farmers and tenant farmers find it difficult to access bank loans. The JLGs typically consist of such farmers to facilitate them in availing loans for farming.

In 2005–06, NABARD had initiated a pilot project 'Micro Enterprise Development Programme' (MEDP) to motivate and assist members of matured SHGs to take up income generating activities on a sustainable basis, in nine districts in nine states, involving 14 NGOs.

During the year 2011–12, NABARD, in association with the Government of India, has formulated a scheme for the promotion of women SHGs in backward and Left Wing Extremism (LWE) affected districts. The main objective of this scheme is to bring out a viable and self-sustainable model for promotion and financing of Women Self Help Groups (WSHGs) by involving an anchor NGO in each of the selected backward districts of the country.

CHALLENGES OR KEY ISSUES IN MICROFINANCE IN INDIA

1. **High Interest Rate:** MFIs are private entities and charging very high interest rates, which is very difficult to pay for the poor. They do not receive any subsidized credit for their lending activities and this is the reason that they need to recover their operational costs from borrowers.

2. **Low Outreach:** In our country, the outreach of MFIs is very low. It is only 8% as compared to 65% in Bangladesh. It has been argued that women are better clients as they are more inclined to save than men, women borrow smaller amounts as compared to men and their repayment performance is also better than men. Women may be better and more reliable clients, but in order to increase their outreach MFIs cannot ignore men as clients.

3. **Low Client Retention:** Client retention is a big challenge that creates a problem in growth and development of the MFIs. There is about 28% client retention in the MFIs. This occurs because people are not properly informed and educated about services and products provided by the institutions.

4. **Language Barrier:** As the education level of clients is low so it is very difficult to communicate with them. 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.

5. **Low Education Level:** Target population of MFIs is people of rural areas and they are mostly illiterate or very less literacy rate in rural areas. It creates a problem in the growth and expansion of the organization because its percentage is around 70% in MFIs.

6. **Fraud:** Fraud is a key issue as it creates a problem in growth and expansion of the organization because its percentage is around 67% in MFIs. Sometimes clients mismanaged the loans also creates the problem of fraud.

7. **Geographic Factors:** MFIs are basically aimed to facilitate the BPL population of the country but there is a lack of infrastructure in those areas so it becomes difficult for MFIs to reach them easily.

8. **Debt Management:** Clients are uneducated about debt management as 70% of the clients in MFIs are unaware that how to manage their debt. Because of the lack of education and understanding, clients 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.

9. **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. The provision of insurance is very less. However, some of the MFIs have started providing insurance services but the efforts are still at an experimental stage.

10. **Unregulated Microfinance Institutions:** MFIs are not required to follow some standard rules and are not subject to minimum capital requirements and prudential norms. It weakens their management and governance. The regulation may be helpful in improving the growth of MFIs in an orderly approach in our country.

11. **High Transaction Cost:** High transaction cost is a big challenge for microfinance institutions. The number of transactions are very less, whereas the fixed cost of those transactions is very high. It cannot vary with the size of the loan.

12. **Low Outreach in Poor States of India:** In India, some states such as Orissa, Bihar, Chhattisgarh, Jharkhand, Uttaranchal, Madhya Pradesh and Uttar Pradesh are lagging behind in microfinance programme. These states hold more than 50% of the total poor in India and the share of these seven states is approximately 25% of total microfinance outreach in India.

SUGGESTIONS

1. Arrangement of proper training for the clients should be organized in an efficient way so that they could have complete knowledge about their debt.

2. Government should make efforts for proper distribution of micro financing in both rural and urban areas of each states of India.

3. Government should make guidelines, rules and regulations for the smooth functioning of micro financing.

4. Insurance facilities should be provided to the clients of micro financing to cover losses or risks.

5. Government and Micro finance institutions should organize seminars and workshops on debt management as most of the clients of micro financing are not or less educated.

6. Interest rate on loans should be reasonable.

7. With the use of advertising and promotional techniques and modes, micro finance institutions should try to educate needy people about new schemes of micro finance.

8. Micro finance institutions should use modern technology to reduce operating costs.

CONCLUSION

Microfinance is a way for fighting poverty, particularly in rural areas, where most of the poorest people live. Giving small amounts of credit at reasonable interest rates to poor people provides an opportunity to set up their own small business.

On the above findings we observed many problems are associated with the MFIs. The Microfinance institutions are lagging behind in terms of providing loans and credit to the needy and deserving poor people, regional imbalance, a proper regulation etc. If the above shortcoming will be eliminated from the MFIs, it would have positive results on the economy, and lead to greater efficiency and improvement of living standards of the poor people.

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