Microfinance: An Overview

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Abstract

Developing Countries have large number of their population living in below poverty line. The percentage of people living below poverty line, though difference exist among countries amounts to about 40 percent of the entire population of the developing world. Any progress without improving the lot of poverty-ridden section of the world population cannot be considered as meaningful progress. Poverty alleviation is one of the primary objectives of any planning in a national economy. Therefore, it becomes imperative to formulate situation specific poverty alleviation policies and programmes for generation of a minimum level of income for rural poor, which form the substantial percentage of national population in developing societies. Thus in India, the central and state governments initiated several programmes to eradicate the poverty and providing micro finance is the important one. Micro finance system can only supplement the role of banks, and financial institutions to help in solving the problems of poverty and unemployment in the country. This paper is an attempt to define and analyze the Need, Role and importance of Microfinance in India. The SHGS (Self help groups) are meeting their social responsibilities under micro-finance in our country. The problems faced by them are also discussed in brief, so that a meaningful conclusion may be drawn to strengthen the micro finance as a tool for eradicating poverty in the country and to make them more effective in future.

Key words : Micro-finance, Poverty, Self help Group (SHG's), Micro finance Institutions (MFI's), SIDBI, NABARAD,RashtriyaGraminVikas (RGVN), Grammen Bank.

Introduction

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of the entire population of the developing world. Any progress without improving the lot of poverty-ridden section of the world population cannot be considered as meaningful progress. Poverty alleviation is one of the primary objectives of any planning in a national economy. Therefore, it becomes imperative to formulate situation specific poverty alleviation policies and programmes for generation of a minimum level of income for rural poor, which form the substantial percentage of national population in developing societies. Thus in India, the central and state governments initiated several programmes to eradicate the poverty and providing micro finance is the important one. Micro finance system can only supplement the role of banks and financial institutions to help in solving the problems of poverty and unemployment in the country.

It is estimated that in India there exist approximately 7.5 crores poor households, out of which 6 crores are rural and 1.5 crores urban households. One estimate assumes that the total annual requirement of credit for the rural poor families would be at least Rs. 15,000 crores on the basis of a maximum need off Rs. 50,000 crores assuming that annual credit usage are Rs. 6000/- per rural household, and Rs.9000/- for poor urban household. An additional Rs. 1000 crore is estimated to be required for housing per year. Apart from micro-credit, they require savings and insurance also. Meanwhile, bank advances to weak section aggregated Rs. 9700 crore during 1997-98 MFIs and SHGs are estimate to have provided about 137 crore (cumulative) up to September, 1998). The above scenario suggests a vast unmet gap in the provision of financial services to the poor. Moreover, 36% of the rural households are found to be outside the fold of institutional credit.

The term 'microfinance' refers to a particular sub-set of financial services which provides small loans to very poor families, most often without any collateral. The loan can be for consumption, production activities or for small businesses. Of late, a range of financial services other than credit such as savings, micro-insurance etc. are also included under microfinance. The characteristics of microfinance are that the financial service is small in magnitude and those who avail of the services is poor or very poor.

Microfinance provides small loans and savings facilities to those who are excluded from commercial financial services. It has developed as a key strategy for reducing poverty. Access to these facilities is seen as a way of providing the poor with opportunities to take an active role in their economy through entrepreneurship. Microfinance is not a magic to lead automatically towards better living conditions for poor people. As a matter of fact, in some cases microfinance has led to deteriorated situations and debt equity ration of the poor.

The last 15 years saw the entry of various types of Microfinance Institutions in the rural credit sector. Most of these MFIs are based on the Grammen Bank of Bangladesh. This model ha the solidarity groups at the base each of which comprising five borrowers. Eight Solidarity Groups constitute a 'Cenres from a 'Cluster' and seven clusters form a branch. Several such branches constitute and MFI. MFIs in India register themselves either as Societies, Trusts, Non banking Financial Companies (NBFCs) or as Local Area Bank (LABs), and are governed by their respective and regulations.

As per this model, MFIs work as 'bank correspondents' or as 'business facilitators' on behalf of commercial banks and commercial banks and facilitate credit delivery by identifying the borrowers, processing and submitting the applications to the banks etc. The loan account will be managed by the bank. The MFIs, however, provide a first loan default guarantee equal to 8-15 percent of the credit limit.

Present Position

The growth of microfinance is visible in many aspects. There are more than 2000 NGOs involved in the NABARD SHG-Bank linkage program. Out of these, approximately 800 NGOs are involved in some of financial intermediation. Further, there are 350 new generation co-operatives providing also act as a form of 'Social Collateral'. Linking the SHGs to the Banks has thus become a workable way of channelizing microcredit to the poor. According to RBI guidelines, banks can lend up to Rs. 5 lakh to SHG without insisting on any sort of collateral. This model will also help in enhancing the savings by members of the SHGs.

In a heartening development, the RBI issued a circular in January 2009 requiring MFIs, to publish their annualized interest rates. However, this does not address the problem of hidden charges and other fees that companies may charge in addition to the flat interest rate they quote.

Problems

So for the problems of in the area micro-finance is concerned it was found that micro-finance is a exclusively meant for poverty unemployment, ensuring equal distribution in the income and wealth in the society, creating some wealth and to raise the standard of living of

the rural & urban people. But the practical difficulty is to identify that target group. Different parameters have been used for measuring the poverty existing in the society but they are going to be different/indifferent area of the country. According to the Micro Credit Summit, the poorest are those people belonging to the bottom fifty percent of the group of people living below a country's nationally defined poverty-line. According to the World Bank, the poor are those who have a level of consumption of at least $1.

The second important problem's is basically concerned with the process of disbursement of the Micro-finance. It is found that the rate of disbursement is comparatively very low in our country. Third important problem which is related with Micro-finance in our country is that No. of Institutions assigned with this responsibility is inadequate. There are not approachable to the target group.

One more problem which are observed in the course of completion of this work is that it is related with the target group. They are unaware about their progressive and productive activities due to lack of Education, publicity and other social problems.

There is a lot of debate on the rates of interest charged by the microfinance institution which are much higher than the priority sector. The interest rates charged are the MJFLs, which range from 21 to 30 percent per annum, are much lower than the rates charged by the money lenders. The rate of interest depend on a number of factors such as the cost of funds, cost of delivery of credit, cost of collection of repayment, cost of providing for bad debts and profit margins, Money lending being a state subject, various states have enacted Money Lending Acts but without much success in regulating the informal banking sector. A technical Group constituted by the Reserve Bank of India under the chairmanship of Shri S.C. Gupta to review legislations on money lending has recently recommended passing of appropriate legislations to transform money lenders into "Accredited Loan Providers" and providing incentives to registered money lenders. While this thinking is in the right direction, it is also equally important to bring in adequate regulation and safeguards to prevent exploitation of the poor by the money lenders. Establishment of a microfinance Ombudsman at district Levels would also be useful in preventing usurious practices. It is also necessary to encourage SHG based group lending as against individual lending as the former empowers the borrowers.

The microfinance sector also requires a proper legal and regulatory framework for its effective functioning and development. Towards this objective, the Central Government has prepared a 'Micro Financial Sector (Development and Regulation) Bill which is presently under consideration by the parliament. Another key problem for any MFL is its own access to credit. The microfinance industry has grown rapidly primarily due to the confidence of the Indian banking sector in the success and sustainability of MFLs. However, with the once-in-a-lifetime global credit crunch coinciding with the increase in MFLs' credit requirements, the Government could do will to give an extra push for banks' funding of MFLs.

Conclusion and Suggestions

In India, numerous government schemes have tried to provide various subsidized services to the poor households. However, various studies have exposed the Limitation of these programs showing the lack of access of mainstream on the local moneylenders in meeting their consumption and micro-enterprise demands. According to an estimate, only 16% credit usage was met by the formal sources, while the remaining 84% was met by the informal services. Despite having a wide network or rural bank branches in the country and implementation of many credit linked poverty alleviation programs, a large number of the very poor continue to remain outside the fold of the formal banking system. Small Industries Development Bank India (SIDBI) mainly uses the network of State Financial Corporation's (SFCs) and commercial banks constraint. State Financial Corporation's (SFCs) are located in rural areas, have low CD ratio but are suffering immensely from lack of skills, incentives and infrastructure support. As can be seen from above, while there is no dearth of institution and branch network in urban and rural areas, this physical outstretch does not translate into access to credit by microfinance sector producers.

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