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MICRO FINANCE AND FINANCIAL INCLUSION

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ABSTRACT

The direct approach of financial inclusion was started in Nov. 2005 when RBI had directed the banks to open "No-Frills Account" with zero or minimal balances. The basic objective of this approach was to allow the unbanked households to maintain an account with minimal balances and permit limited number of transactions per month. Such accounts were used overtime by the government to make welfare payments like pensions, cash subsidy, social security benefits and wage payments under MGNREGA. The "No-Frills Account" increased from about 5 lakhs to over 5 crores presently. However, Skoch development foundation in its study stated that out of total "No-Frills Account" opened between April 2007 and March 2009, only 11 % were operational which an issue of concern was. Further, on the recommendations of Financial Inclusion Committee headed by Dr. Rangarajan in 2006, two funds i.e. Financial Inclusion Fund was established to meet the cost of development and promotion of financial inclusion and Financial Inclusion Technology Fund was established to support the technology efforts in the process of financial inclusion. These funds with a corpus Rs. 500 crore each were operated by NABARD. The other institutions which provide microfinance in India are Small Industries Development Bank of India (SIDBI), RashtriyaMahilaKosh, Commercial Banks, Regional Rural Banks, Cooperative Banks and Non-Banking Financial Companies (NBFCs). These institutions provide finance through the concept of Joint Liability Group (JLP). A JLP is an informal group comprising of 10 to 15 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee. Presently, these institutions constitute the 42% of the microfinance sector in terms of loan portfolio and dominated by NBFCs which cover more than 80% of the total loan portfolio through MFI channel.

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INTRODUCTION

RBI in January 2006 introduced Business Correspondents/Business Facilitators (BC/BF) models for providing financial and banking services. The activities performed by BCs include disbursal of small value credit, recovery of principal/collection of interest, collection of small value deposits, sale of micro insurance/mutual fund/pension products/other third party product, receipt and delivery of small value remittances/other payment instruments. Similarly, BFs perform the activities like identification of borrowers, collection and preliminary processing of loan applications, creation of awareness about savings and advise on managing money, Debt counseling, processing and submission of loan applications to banks, post sanction monitoring, promotion, nurturing, monitoring and handling of SHGs, and follow up for recovery.

Recently Government of India introduced a scheme to directly transfer the government subsidies and social security benefits to the accounts of the beneficiaries; who in turn could draw the money from BCs in their village itself. For the effective implementation of scheme, banks are asked to provide banking facilities to areas with population of 1000-2000 in North-Eastern states and hilly states; and with population of 1600-2000 in all states/UTs by March 2013.

Microfinance industry is considered as a tool of financial inclusion as well as poverty reduction for the marginalized and disadvantaged people of rural areas. Thus, it has considered as a significant and emerging issue in developing countries and generated a great deal of interest among academicians, researchers, policymakers and economists. The main objective of this paper is to study the role of microfinance in economic development and the challenges of this sector in India.

MICROFINANACE AND POVERTY REDUCTION

India consists over a quarter of its population below to poverty line. The World Bank reports that India is a home around some 260 to 290 million poor, numbers that rise to around 390 million if poverty is measured by the international standard of those living on less than 1US$

dollar a day. Almost half of India‟s poor, more or less 133 million, are found in three states: Uttar Pradesh, Bihar, and Madhya Pradesh. Rural area in India is the home of three quarters of India‟s poor which is supported by the increasing urban and rural disparities. The Indian government‟s poverty reduction strategy focuses on infrastructure, social development (especially education and health), and rural livelihoods. The improvement of rural livelihoods is the aspect of poverty reduction that Microfinance Institutions concentrate on. Most poor people manage resources to develop their enterprises and their home over a time. Financial services could enable the poor to force their initiative, accelerating the process of assembling incomes, assets and economic safety.

Traditional finance institutions rarely lend money to serve the needs of low-income families and women-headed households. However, the income of many self-employed households is not stable, regardless of its size. A large number of small loans are needed to serve the poor, but lenders prefer dealing with large loans in small numbers to minimize administration costs. They also look for guarantee which many low-income households do not have in hand. Over the last ten years, however, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, pay back their loans and use the profits to increase their income and assets. This is not shocking since the only realistic alternative for them is to borrow the money from informal market. Community banks, NGOs and credit groups around the world have shown that these microenterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

MICROFINANCE AND SELF HELP GROUPS (SGHs)

There are two common approaches of Micro Finance India - The Self-help group method and the Grameen system. An SHG is an unofficial group of approximately 10-20 members. The members of the SHG are joined for the specific purpose of facilitating saving and credit services for its members. This is made possible through members pooling their resources to create a common fund. The process and social involvement of SHGs are intended to be instruments of empowerment, building the capacity of members to eventually conduct and manage SHGs for themselves, and enabling them to have greater autonomy in financial

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decision making as well as wider social participation. SHG meetings are set to take place at regular intervals and at a designated time. Group members are drawn from the same social-economic layer and work on the basis of equal participation and contribution from all members. The groups are chaired by one lead member at a time; this role is usually rotated to allow capacity building for all members. Meetings are structured and accurate and up to date records of all financial transactions, group decisions and actions are compiled. Once established, SHGs are encouraged to make links with other SHGs and eventually with financial institutions to allow access to further financial assistance.

MICROFINANCE AND WOMEN EMPOWERMENT

Women are essential part of the society. The role of women in economic activities and decision making is very low. Micro financial schemes plays vital role in increasing women‟s participation in economic activities and decision making. There has been huge growth of organizations, known as Microfinance Institutions (MFIs) in this field to deal with the micro financial activities. With increasing demand for rural finance, and the shortages of formal sources, the MFIs have tremendous challenges and opportunities in microfinance in India. In India self-help groups (SHGs) constitutes of 85-95 % women. The reasons for this is that women are familiar with finances responsibility; making them trustworthy, reliable and prompt savers. Empowerment of women also occupies central place to wide development goals. Women empowerment is critical factor in the eradication of poverty, as the women are the key contributors to the economic and to fighting with poverty through both remunerative and un-remunerative work at home, in the community and in the workplace. SHGs have been recognized as one efficient means of empowering women.

SUCCESS FACTORS OF MICRO-FINANCE IN RURAL INDIA

Over the last ten years, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grass root savings and credit groups around the world have shown that these micro enterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

FOR NGOs

1. The field of development itself expands and shifts emphasis with the pull of ideas, and NGOs perhaps more readily adopt new ideas, especially if the resources required are small, entry and exit are easy, tasks are (perceived to be) simple and people's acceptance is high – all characteristics (real or presumed) of microfinance.
2. Canvassing by various actors, including the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), Friends of Women's World Banking (FWWB), RashtriyaMahilaKosh (RMK), Council for Advancement of People's Action and Rural Technologies (CAPART), RashtriyaGraminVikasNidhi (RGVN), various donor funded programmes especially by the International Fund for Agricultural Development (IFAD), United Nations Development Programme (UNDP), World Bank and Department for International Development, UK (DFID)], and lately commercial banks, has greatly added to the idea pull. Induced by the worldwide focus on microfinance, donor NGOs too have been funding microfinance projects. One might call it the supply push.
3. All kinds of things from khadi spinning to Nadep compost to balwadis do not produce such concrete results and sustained interest among beneficiaries as microfinance. Most NGO-led microfinance is with poor women, for whom access to small loans to meet dire emergencies is a valued outcome. Thus, quick and high 'customer satisfaction' is the USP that has attracted NGOs to this trade.

FOR FINANCIAL INSTITUTIONS AND BANKS

Microfinance has been attractive to the lending agencies because of demonstrated sustainability and of low costs of operation. Institutions like SIDBI and NABARD are hard-nosed bankers and would not work with the idea if they did not see a long term engagement – which only comes out of sustainability (that is economic attractiveness).On the supply side, it is also true that it has all the trappings of a business enterprise, its output is tangible and it is easily understood by the mainstream. This also seems to sound nice to the government, which in the post liberalisation era is trying to explain the logic of every rupee spent. That is the reason why microfinance has attracted mainstream institutions like no other developmental project.Perhaps the most important factor that got banks involved is what one might call the policy push.Given that most of our banks are in the public sector, public policy does have some influence on what they will or will not do. In this case, policy was followed by diligent, if meandering, promotional work by NABARD. The policy change about a decade ago by RBI to allow banks to lend to SHGs was initially followed by a seven-page memo by NABARD to all bank chairmen, and later by sensitisation and training programmes for bank staff across the country. Several hundred such programmes were conducted by NGOs alone, each involving 15 to 20 bank staff, all paid for by NABARD. The policy push was sweetened by the NABARD refinance scheme that offers much more favourable terms (100% refinance, wider spread) than for other rural lending by banks. NABARD also did some system setting work and banks lately have been given targets. The canvassing, training, refinance and close follow up by NABARD has resulted in widespread bank involvement.

CRITICAL ISSUES FOR MICRO FINANCE INSTITUTIONS IN INDIA

This is not a point of consideration that Micro financial services have capability to offer better services than conventional banking services and carry out the needs of the underprivileged people. The significant factor is that external Micro financial services should join hand to the running system of lending and/or borrowing money in rural areas instead of throwing them out. In this way the poor people especially women who require the fund to run their business and family activities in a well-organized manner will get benefitted more. Some critical issues for microfinance organizations are as follows:

SUSTAINABILITY

The primary issue is related to sustainability. It has been reported in much news that the Micro financial institutions are comparatively costlier in terms of delivery of financial services. This is partially explained by the fact that the cost of supervision of credit is high, while the loan quantity and loan volume is low. Therefore it is necessary for MFIs to develop

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strategies for increasing the range and volume of their financial services.

LACK OF CAPITAL

The next part of concern for MFIs, which is on the expansion path, is that they face a scarcity 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.

BORROWINGS

In comparison with earlier years, MFIs are now finding it relatively easier to raise loan from banks. This change came after the year 2000, when RBI allowed banks to lend to MFIs and treat such lending as part of their priority sector funding obligations. Private sector banks have designed innovative products such as the Bank Partnership Model to fund MFIs and have started viewing the sector as a good business proposition. But banks need to be most careful when they feel most confident about MFIs. Bank should find the right technologies to assess the risk of funding MFIs.

CAPACITY OF MFIs

It is now accepted that MFIs has both social and commercial dimensions. Since the sustainability of MFIs and their clients complement each other, it follows that building up the capacities of the MFIs and their primary stakeholders. These are preconditions for the successful delivery of flexible, client responsive and innovative microfinance services to the poor.

SUGGESTIONS:

1. Presently, there is no distinctive regulatory framework for the MFIs in India. Regulation of the MFIs is largely in the purview of the state governments. So there is a need of an exclusive regulation to regulate to MFIs in India.
2. Ensure the quality of MFIs in an environment of exponential growth. Due to the fast growth of the SHG-Bank Linkage Programme, the quality of MFIs has come under

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stress. This is reflected particularly in indicators such as the poor maintenance of books and accounts etc.

3. Proper training for the clients should be organized in an efficient way so that they could know each and every small things about their debt
4. Ensure the uniform distribution of micro financing in both rural and urban areas of each states of India.

CONCLUSION

Finance is the lubricant, which oils the wheels of development. Micro finance is leaving enormous economic and social impact. Microfinance provide both savings and loan facilities An MFI is likely to provide the much needed funds to the potential entrepreneurs of the rural India. Also it is anticipated that the people would become socially more advanced as they come into touch with the outside world. In order to be sustainable, microfinance lending should be fixed on market principles because large scale lending cannot be completed through financial support. A core conclusion of this paper is that microfinance can contribute into solving the problem of insufficient housing and rural services as an integral part of poverty alleviation programs and empower women to play a vital role in the society. Eventually it would be ideal to improve the creditworthiness of the poor and to make them more bankable to financial institutions and allow them to meet the criteria for long-term credit from the formal sector. Microfinance institutions have a lot to contribute to this by building financial discipline and educating borrowers about compensation requirements.

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