ISSUES IN MICROFINANCE SECTOR IN INDIA

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ABSTRACT

Microfinance is defined as any activity that includes the provision of financial services such as credit, savings, and insurance to low income individuals which fall just above the nationally defined poverty line, and poor individuals which fall below that poverty line, with the goal of creating social value. The creation of social value includes poverty alleviation and the broader impact of improving livelihood opportunities through the provision of capital for micro enterprise, and insurance and savings for risk mitigation and consumption smoothing. A large variety of actors provide microfinance in India, using a range of microfinance delivery methods. Since the ICICI Bank in India, various actors have endeavored to provide access to financial services to the poor in creative ways. Governments also have piloted national programs, NGOs have undertaken the activity of raising donor funds for on-lending, and some banks have partnered with public organizations or made small inroads themselves in providing such services. This has resulted in a rather broad definition of microfinance as any activity that targets poor and low-income individuals for the provision of financial services.

Introduction

In India Microfinance has been a development and economic tool which has helped in bringing about financial inclusion. It has been viewed as an important tool of women empowerment and to alleviate poverty. It has served to provide financial services and credit to the unprivileged and unbanked sector in India thereby bringing about financial inclusion. The loans provided by microfinance institutions serve the low-income population in various ways as follows:

- They provide working capital loans for business purposes.
- They provide loans for accessing necessities such as food, clothes, shelter and education.
- They serve as alternatives to the loans provided by money lenders.

In addition to various micro finance institutions, various other players contributing to provision of microcredit include banks, insurance companies, agricultural and dairy co-operatives, etc.

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Microfinance Definition

According to International Labor Organization (ILO), "*Microfinance is an economic development approach that involves providing financial services through institutions to low income clients*"

In India, Microfinance has been defined by "The National Microfinance Taskforce, 1999" as "*provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards*".

"The poor stay poor, not because they are lazy but because they have no access to capital."

The dictionary meaning of 'finance' is management of money. The management of money denotes acquiring & using money. Micro Finance is buzzing word, used when financing for micro entrepreneurs. Concept of micro finance is emerged in need of meeting special goal to empower under-privileged class of society, women, and poor, downtrodden by natural reasons or men made; caste, creed, religion or otherwise. The principles of Micro Finance are founded on the philosophy of cooperation and its central values of equality, equity and mutual self-help. At the heart of these principles are the concept of human development and the brotherhood of man expressed through people working together to achieve a better life for themselves and their children.

Traditionally micro finance was focused on providing a very standardized credit product. The poor, just like anyone else, (in fact need like thirst) need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. Thus, we see a broadening of the concept of micro finance--- our current challenge is to find efficient and reliable ways of providing a richer menu of micro finance products. Micro Finance is not merely extending credit, but extending credit to those who require most for their and family's survival. It cannot be measured in term of quantity, but due weightage to quality measurement. How credit availed is used to survive and grow with limited means.

MICROFINANCE INSTITUTIONS IN INDIA

A range of institutions in public sector as well as private sector offers micro finance services in India. They can be broadly categorized into two categories namely,

1. Formal institutions

2. Informal institutions.

The former category comprises Apex Development Financial Institutions, Commercial Banks, Regional Rural Banks, and Cooperative Banks that provide micro finance services in addition to their general banking activities and are referred to as micro finance service providers.

On the other hand, the informal institutions that undertake micro finance services as their main activity are generally referred to as micro Finance Institutions (MFIs). While both private and public ownership are found in the case of formal financial institutions offering microfinance services, the MFIs are mainly in the private sector. The micro finance service providers include apex institutions like National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), and, RashtriyaMahilaKosh (RMK).

The micro finance initiative in private sector can be traced to the initiative undertaken by Ms.Ela Bhatt for providing banking services to the poor women employed in the unorganized sector in Ahmedabad City of Gujarat State.

NABARD during the early eighties conducted a series of research studies in association with MYRADA (a leading NGO from South India) and also independently which showed that despite having a wide network of rural bank branches that implemented specific poverty alleviation programmes and self-employment opportunities through bank credit for almost two decades, a very large number of the poorest of the poor continued to remain outside the fold of the formal banking system. NABARD, however, also took a conscious decision to experiment with other successful strategies such as replicating Grameen, wholesaling funds through NGOMFIs. The dominant model of microfinance – the group lending model pioneered by the Grameen Bank in Bangladesh – socializes the costs of lending to poor women by providing them access to credit on the basis of "social collateral" obtained through membership in borrower groups. Here social capital helps correct for imperfect information about borrowers lacking in formal credit and employment histories and substitutes for collateral by ensuring against default through social sanction and peer enforcement.

Micro Finance Products

1. **Credit**

Credit methodology lies at the heart of microfinance and its quality is one of the most determinant factors for the efficiency, impact and profitability of a microfinance institution (MFI). Credit methodology is comprised of a host of activities involved in lending including sales, client selection and screening, the application and approval process, repayment monitoring, and delinquency and portfolio management. It is also linked to the institutional structure and human resource policies such as hiring, training and compensating staff. Getting the credit methodology and product mix right is therefore one of the most demanding as well as rewarding challenges MFIs face.

2. **Savings Products**

For most of its history, the microfinance industry has focused on delivering micro loans to micro entrepreneurs, and it is still in the process of seeking greater scale at greater speed for delivering micro credit. The experience of microfinance institutions (MFIs) across the globe that mobilize savings, however, demonstrates that the demand for deposit products is many times that of credit.

Accordingly, savings mobilization is becoming a critical strategic goal for MFIs, especially as microfinance markets become more competitive. MFIs are looking to build their capacity to mobilize savings, either as a funding strategy to support growth while reducing financial costs of funds, or, as a marketing strategy to promote customer loyalty and retention.

One of the challenges that MFIs will face when mobilizing deposits is controlling expenses, as operating costs of managing and delivering savings services are relatively high. Micro savings customers are also more sensitive to charges and fees than wealthier clients, given the smaller average balances and income levels.

Another key challenge is for the MFI to diversify its target segment, as mobilizing savings usually requires attracting a different clientele than the typical micro entrepreneur. Savings mobilization also requires certain standards for quality in customer service, which depends on key resources and capabilities, such as technology, processes and qualified staff. For institutions transforming into financial intermediaries, the challenges are great as other issues – such as changing a corporate culture, implementing practices required by regulation, developing key functions like treasury and risk management, and building a brand image – require commitment and significant investment.

3. Insurance Products

Losses due to natural disasters, fire or death of a family member can be devastating for anyone. For micro entrepreneurs and other low-income populations, even common illness can wipe out a lifetime of work, leaving them without any resources to start over. Micro insurance products can help mitigate the effects of losses on clients and their families so that they can retain and build on the gains they have worked so hard to achieve and continue on the path out of poverty.

Micro insurance is a nascent industry, which has made significant strides in the last few years. Products are specially designed to meet the needs of poor clients: premium payments are kept to a minimum, terms and conditions are clear and simple, and exclusions and requirements such as medical examinations are avoided to the greatest extent possible. Micro insurance includes but is not limited to: Life, Health, Accidental Death and Disability, and Property products. There are also country-specific challenges faced by MFIs related to the country's regulatory environment and the availability of Insurance companies willing and able to underwrite client-appropriate programs that are competitively priced.

4. Remittances

These are transfer of funds from people in one place to people in another, usually across borders to family and friends. Compared with other sources of capital that can fluctuate depending on the political or economic climate, remittances are a relatively steady source of funds.

ISSUES IN MICROFINANCE

Sustainability

The first challenge relates to sustainability. MFI model is comparatively costlier in terms of delivery of financial services. An analysis of 36 leading MFIs shows that 89% MFIs sample were subsidy dependent and only 9 were able to cover more than 80% of their costs.

This is partly explained by the fact that while the cost of supervision of credit is high, the loan volumes and loan size is low. It has also been commented that MFIs pass on the higher cost of credit to their clients who are 'interest insensitive' for small loans but may not be so as loan sizes increase. It is, therefore, necessary for MFIs to develop strategies for increasing the range and volume of their financial services.

Lack of Capital

The second area of concern for MFIs, which are on the growth path, is that they face a paucity 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.

Presently, there is no reliable mechanism in the country for meeting the equity requirements of MFIs.The book value multiple is currently the dominant valuation methodology in microfinance investments.

In the case of startup MFIs, using a book value multiple does not do justice to the underlying value of the business. Typically, startups are loss making and hence the book value continually reduces over time until they hit breakeven point. A book value multiplier to value startups would decrease the value as the organization uses up capital to build its business, thus accentuating the negative rather than the positive.

Financial service delivery

Another challenge faced by MFIs is the inability to access supply chain. This challenge can be overcome by exploring synergies between microfinance institutions with expertise in credit delivery and community mobilization and businesses operating with production supply chains such as agriculture.

The latter players who bring with them an understanding of similar client segments, ability to create microenterprise opportunities and willingness to nurture them, would be keen on directing microfinance to such opportunities.

This enables MFIs to increase their client base at no additional costs. Those businesses that procure from rural India such as agriculture and dairy often identify finance as a constraint to value creation. Such businesses may find complementarities between an MFI's skills in management of credit processes and their own strengths in supply chain management.

HR Issues

Recruitment and retention is the major challenge faced by MFIs as they strive to reach more clients and expand their geographical scope. Attracting the right talent proves difficult because candidates must have, as a prerequisite, a mindset that fits with the organization's mission.

Many mainstream commercial banks are now entering microfinance, who are poaching staff from MFIs and MFIs are unable to retain them for other job opportunities. 85% of the poorest clients served by microfinance are women. However, women make up less than half of all microfinance staff members, and fill even fewer of the senior management roles.

The challenge in most countries stems from cultural notions of women's roles, for example, while women are single there might be a greater willingness on the part of women's families to let them work as front line staff, but as soon as they marry and certainly once they start having children, it becomes unacceptable. Long distances and long hours away from the family are difficult for women to accommodate and for their families to understand.

Micro insurance

First big issue in the micro insurance sector is developing products that really respond to the needs of clients and in a way that is commercially viable. Secondly, there is strong need to enhance delivery channels. These delivery channels have been relatively weak so far. Micro insurance companies offer minimal products and do not want to go forward and offer complex products that may respond better.

Micro insurance needs a delivery channel that has easy access to the low-income market, and preferably one that has been engaged in financial transactions so that they have controls for managing cash and the ability to track different individuals.

Thirdly, there is a need for market education. People either have no information about micro insurance or they have a negative attitude towards it. We have to counter that. We have to somehow get people - without having to sit down at a table - to understand what insurance is, and why it benefits them. That will help to demystify micro insurance so that when agents come, people are willing to engage with them.

Adverse selection and moral hazard

The joint liability mechanism has been relied upon to overcome the twin issues of adverse selection and moral hazard. The group lending models are contingent on the availability of skilled resources for group promotion and entail a gestation period of six months to one year. However, there is not sufficient understanding of the drivers of default and credit risk at the level of the individual. This has constrained the development of individual models of micro finance. The group model was an innovation to overcome the specific issue of the quality of the portfolio, given the inability of the poor to offer collateral.

However, from the perspective of scaling up micro financial services, it is important to proactively discover models that will enable direct finance to individuals.

CONCLUSION

Creating self employment opportunity is one way of attacking poverty and solving the problems of unemployment. There are over 24 crore people below the poverty line in our country. The scheme of micro finance has been found as an effective instrument for lifting the poor above the level of poverty by providing them increased self-employment opportunities and making them credit worthy. A basic effort of last decade, the micro finance objective in India has reached at top point similar to Bangladesh. With some efforts substantial progress can be made in taking MFIs to the next orbit of significance and sustainability. There is a need of designing financially sustainable models and increase outreach and scale up operations for poor in India. People belong to villages are still unaware about banking policies and credit system. So, NGO should communicate to them and share their view with villagers. Banks should convert and build up professional system in to social banking system for poor. Government should also provide support for capacity building initiatives and ensure transparency and enhance credibility through disclosures.

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