Research Article

Challenges of Microfinance Sector in India

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Abstract:

India has numerous strengths and can become the principal supplier of skilled workers to developed countries with ageing societies experiencing acute labor scarcity. Thus this prevailing Indian Diaspora and concrete efforts towards reduction in social and economic disparities can work as a prospective catalyst for the smooth transition of India into a world economic power. There is an evolving need to overpass the rural urban divides in a time-bound manner failing which there could be serious unfavorable implications for the Indian economy, society and polity. This rural –urban divide and inclusive growth of citizens of India can be achieved by providing finance to people when they require it. The present paper discusses the various challenges faced by microfinance sector to reach profitably to the grassroots level.

Key Words: Inclusive growth, Micro finance Institutions, SBLP, SHG,.

Introduction:

Financial sector policies in India have long been driven by the objective of increasing financial inclusion, but the goal of universal inclusion is still a distant dream. For a financial system to be truly inclusive, it should meet the needs of everyone who can fruitfully use financial services, including the poor. For the developing countries like India, microfinance has come as a breakthrough in the philosophy and practices of poverty eradication, economic empowerment and inclusive growth. Microfinance refers to small scale financial services for both credits and deposits- that are provided to people who farm or fish or herd; operate small or micro enterprise where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries in both rural and urban areas.

However, over the last several years, the Indian microfinance industry has undergone considerable evolution. It helped the poor to catch up with the rest of the economy as it grows. It also helped the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. But still it has been observed there are many problems faced by poor people in accessing and utilizing these funds not in India but also throughout the world. Researches and studies show that there is need for deepening / new product / different model for micro finance as the existing level has not helped them sufficiently to come out of poverty. There is now a growing appreciation of the „empowerment" dimensions of finance, of the extent to which it can give ordinary people and the poor access to opportunity and the ability to escape ossified social structures. The Indian state put stress on providing financial services to the poor and underprivileged since independence. The commercial banks were nationalized in 1969 and were directed to lend 40% of their loan able funds, at a concessional rate, to the priority sector. The priority sector included agriculture and other rural activities and the weaker strata of society in general.

The aim was to provide resources to help the poor to attain self sufficiency. They had neither resources nor employment opportunities to be financially independent, let alone meet the minimal consumption needs. To supplement these efforts, the credit scheme Integrated Rural Development Programme (IRDP) was launched in 1980. But these supply side programs (ignoring the demand side of the economy) aided by corruption and leakages, achieved little. Further, 'The share of the formal financial sector in total rural credit was 56.6%, compared to informal finance at 39.6% and unspecified sources at 3.8%. [RBI 1992]. Not only had formal credit flow been less but also uneven. The collateral and paperwork based system shied away from the poor. The vacuum continued to be filled by the village moneylender who charged interest rates of 2 to 30% per month (Rural Credit and Self Help Groups- Microfinance needs and Concepts in India- K.G.Karmakar 1999). 70% of landless/marginal farmers did not have a bank account and 87% had no access to credit from a formal source.(WorldBank NCAER, Rural Financial Access Survey 2003).

Status 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 unorganized sector in Ahmadabad 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. Today, the top five private sector MFIs reach more than 20 million clients in nearly every state in India and many Indian MFIs have been recognized as global leaders in the industry. According to recent RBI estimates, there are over 450 million "unbanked people" in India, most of whom live in rural areas. The term "unbanked" refers to people who have no access to formal financial services, but rather must rely on either family, or informal providers of finance, such as the village moneylender. It is undisputed that access to finance is critical for enabling individuals and communities to climb out of poverty. It is also generally agreed that relying on the limited resources of village moneylenders exposes the poor to coercive lending practices, personal risks and high interest rates, which can be a much as 150%

Table 1: Growth Trends in Self-help Group Bank Linkage Program (SBLP)

	2006	2007	2008	2009	2010
No. of SHGs provided with bank loans	2238565	2924973	3625941	4224338	4587178
Average disbursed loan per group (`)	37574	44343	46800	74000	115820
Outstanding loans (`Rs. Billion)		123.66	169.99	226.79	272.66
Incremental groups million		0.69	0.70	0.60	0.36
Incremental loans outstanding (billion)			46.33	56.80	45.87

Source: NABARD

The provisional data of National Bank for Agricultural and Rural Development (NABARD) indicates that the self-help group bank linkage program (SBLP) growth might be in a declining trend both in outreach and loan portfolio. The number of self-help groups (SHGs) that had outstanding loans was 4.58 million at the end of March 2010 which represents 8.5 per cent growth over the last year (Rs 4.22 million). The volume of outstanding loans was at Rs 272.66 billion representing an increase of 20 per cent over the previous year (Rs226.79 billion). The incremental loan outstanding achieved under the SBLP was of the order of ` 45.87 billion which is lower than the incremental loan outstanding achieved by Microfinance Institutions (MFIs) during the year. The disbursement by banks to SHGs has increased by 49 per cent over the last year (Rs. 122.53 billion) to Rs.183.43 billion. Savings by SHG members increased to Rs. 63.58 billion from Rs 55.45 billion. The number of SHGs with savings increased from 6.12 million to 6.81 million, by 11 per cent. The average disbursement per group increased to Rs 115000 which was a substantial step up over the last year (Rs 76000).

While disbursement had increased impressively, the same did not strongly reflect on outstanding loans. The possible reason is that the loans are short term compared to the past practice of providing three year loans to SHGs. In line with the trends noticed last year, the programme has shown that it is losing steam as seen from the single digit growth rate in outreach, but over a very large base. SBLP has gone in to a decline relative to the MFIs' performance. The MFIs added 4.1 million clients and Rs. 66.10 billion to their outstanding loan portfolio. SBLP added 4.7 million clients and Rs 45.87 billion to loan portfolio. While last year, MFIs added more clients than SBLP, in the current year, they have added more to the loan portfolio than SBLP. But SBLP continued to grow on the savings side. With 88.5 million savers, SHGs are a significant first point of access to a direly needed financial service.

The average outstanding loan per SHG was Rs59440 compared to Rs. 53670 of the previous year, reflecting a healthy deepening in loans. The average loan per member increased to Rs. 4570, by 10 per cent over the last year. Compared to last year's growth, current year's growth in absolute terms and percentage terms was less both in client outreach and loans.

Table 2: Saving Trends of SHG's

Savings of SHGs placed with banks							
	no. of SHGs			amount saved (` million)			Average savings per SHG (`) 2010
agency	2008	2009	2010	2008	2009	2010	
Commercial Banks	2810750	3549509	4062822	20777.3	27729.9	36812.7	9060
Regional Rural Banks	1386838	1628588	1646059	11664.9	19897.5	12697.7	7714
Cooperative Banks	812206	643050	1108870	5411.7	7828.8	14069.8	12688
Total	5009794	6121147	6817751	37853.9	55456.2	63580.2	9325

Source: NABARD

One of redeeming features during the current year was a substantial increase in the number of SHGs that saved with the banking system. As at the end of March 2009, 6.12 million groups had saved their surpluses with banks. At the end of March 2010, the number of groups that saved increased to 6.81 million. Savings by SHGs increased by ` 81.24 billion, that is, by 14.6 per cent over the last year (Table 2.2). The continuing growth in savings over the years is a reflection of how this opportunity is valued by the poor. Of the amounts saved, a lion's share was saved with the commercial banks. 58 per cent of SHGs' savings were with commercial banks at an average of Rs. 9060 per group. In case of commercial banks, the average per group savings increased by 16 per cent. Regional Rural Banks (RRBs) had a share of 20 per cent of SHG savings. There is a decline in the average savings per group in case of RRBs from the last year's Rs. 12400 to Rs. 7700. Cooperatives put in a good performance, raising their share of SHG savings from 14 per cent last year to 22 per cent in the current year. The average savings per group with cooperatives increased by 50 per cent over last year's level (Rs. 8020). Among the states, Andhra Pradesh had the maximum savings mobilization at Rs. 12.54 billion followed by Tamil Nadu (Rs. 8.97 billion). The average savings per group among mainstream states (with at least 25000 SHGs) was the highest in Gujarat at Rs. 19410 followed by Uttarakhand, Bihar, Karnataka and Tamil Nadu. Andhra Pradesh did not have a high savings average compared to many other states. Part of the reason is that savings made by groups are placed in fixed deposits with banks. The savings data presented is confined to amounts placed in savings accounts with banks. Parts of the savings of SHGs are used for lending among the group members.

This data is not collected and hence it is difficult to get an idea of the total amount of savings of members. Suffice to conclude that savings of SHGs are more than what is seen as placed with banks.

Table 3: Penetration Intensity of Microfinance

Top 5			
Name of State	MPI*	Name of State	MPPI**
Andhra Pradesh	3.64	Andhra Pradesh	6.35
Tamil Nadu	2.27	Tamil Nadu	2.77
Orissa	2.00	Kerala	2.49
Karnataka	1.57	Karnataka	1.74
W. Bengal	1.48	W. Bengal	1.65
Last 5			
Jammu and Kashmir	0.03	Jammu and Kashmir	0.13
Punjab	0.07	Bihar	0.14
Bihar	0.20	Punjab	0.22
Haryana	0.23	Madhya Pradesh	0.27
Gujarat	0.26	26 Uttar Pradesh	0.32

Source: NABARD

*The intensity of penetration of microfinance (also known as MPI)

**Intensity of Penetration of Microfinance among Poor (MPPI)

As in the previous year, microfinance penetration index (MPI) has been computed for the different states for the year 2010 as well. The index measures whether the client acquisition in different states is proportional to the population and population of poor households. The southern region has more than proportionate coverage of microfinance. West Bengal is the new entrant in the list of top five states under MPI and MPPI. Four out of top five states under MPPI are from the southern region. Among low penetrations states, Bihar, and Jammu and Kashmir figure under MPI and MPPI. Under MPPI, Madhya Pradesh and Punjab have made an entry into the list. The index is also a measure of comparative performance and, hence, when a state makes absolute progress in microfinance, it could still lose out on rankings on account of comparative better performance by others. Across regions, apart from South, East seems to have done marginally well. The MPI is better than MPPI in eastern states. The central region comprising most of the poorest states has a long way to go in improving microfinance penetration levels.

Challenges faced by Microfinance Sector

Microfinance institutions basically cater to the need of the people who are in the lower strata of economic system. Basic problem is of over-indebtedness, clients drown themselves in debt by borrowing money from multiple institutions. Due to increased number of microcredit institutions, a lack of regulation and the absence of a strong credit bureau that would make it easier to identify clients who have multiple loans. "The information whether clients have multiple loans or not are always hard to come by. In absence of this the client borrows from a number of institutions and debt burden increases so much that they are unable to pay. Ultimately these types of clients opt for suicide as happened in Andhra Pradesh. MFIs lend money at exorbitant interest rates which range from 20 percent to 40 percent In the name of empowering the poor, this form of organized exploitation has given many reasons for businessmen to make money at the cost of the poor, who are often seen as "*fortune at the bottom of the pyramid.*" Previously, money lenders lent money at higher rates of interest because it was the individual who was lending money, but now, it is an institution comprising of a group of individuals who are lending money and in turn, pocketing extra money from the poor in the name of interest rate. SHGs consisting of poor members with identical socioeconomic backgrounds are usually more sensitive to the credit needs of the poor.

Though loan repayment is a joint liability of the group but, in reality, individual liability, is stressed upon. Maintaining group reputation leads to the application of tremendous peer pressure. Poor people are very often denied access to credit for any purpose, making the discussion of the level of interest rate and other terms of finance irrelevant. Therefore the fundamental problem is not so much of unaffordable terms of loan as the lack of access to credit itself. The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the modes of operation followed by financial institutions and the economic characteristics and financing needs of low-income households. For example, commercial lending institutions require that borrowers have a stable source of income out of which principal and interest can be paid back according to the agreed terms. 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 collateral with a clear title - which many low-income households do not have. In addition bankers tend to consider low income households a bad risk imposing exceedingly high information monitoring costs on operation. It is not just enough to have growth but inclusion. Inclusion means giving all standards of living, education, and proper health care to the persons. Due to Lack of awareness among rural folks about the objective of microfinance and process to obtain finance, these people are generally illiterate one and are unaware about the intricacies to obtain microfinance.

Suggestions:

Although the microfinance sector is plagued by a number of problems but there is a way out for the problems faced by this sector. Improvements are required from the side of govt, Microfinance institutions and individual clients. Promotion of creation of SHG's in the community can help a lot to avoid the problem of over-indebtedness. Internal lending among the beneficiaries was allowed and no credit would be granted to an SHG without savings by the individual .Members of SHG provided loans to beneficiaries at zero percent interest, except that the time period for repaying the amount was fixed.

This led to the creation of pool of money for the poor. Secondly, participatory budgeting model followed in Venezuela exemplifies how people participate in a community's activities and plan the budget according to the requirements of the members in the community who are represented by elected leaders. Money lending is a part of this structured process in which a member of the community is appointed to check the flow of capital. This brings in transparency and gives power to the people to make decisions based on their needs and necessities and also to generate income. Indian Government and the RBI have a policy of "financial inclusion". As part of this policy, the government requires Indian banks to lend to "priority sectors", one of which is the rural poor. Until recently, banks were happy to lend money to MFIs who would then on-lend funds, primarily to poor women across rural India. The banks have welcomed this policy because historically they tended to charge MFIs average interest rates of 12-13% and benefited from 100% repayment rates. Thus, by lending to MFIs, banks have been able to meet their "priority sector" lending requirements with what historically has amounted to a risk-free and very profitable arrangement. Microfinance in India is currently being provided by three sectors: the government, the private sector and charities. These three sectors, as large as they are, have only a small fraction of the capital and geographic scale required to meet the need of finance.

Government should take initiative and design the programme as per needs of the rural women. In SHGs the group should be formed among the members belonging to same area so that they can communicate with each other's easily. More and more programmes on awareness, imparting education and improving should be conducted. Communication skills workshops in rural areas may be organized which will lead to raise their bargaining power in the urban market. Effective programme should be organized on optimum utilization of credit and subsidies, results in reducing mis-utilization of capital. Arranging more trades and fairs throughout the year or some permanent avenues for selling out the rural products can give a solution to them.

Self help groups Self Help Groups should organize monthly meetings as per convenience of the group members, so that each and every member can able to participate it after covering their household duties. The groups should be formed among the members belonging to same area so that they can communicate with each other easily. The SHGs have improved the standard of living of women as participants, decision makers and beneficiaries in the democratic, economic and socio-cultural life. The important suggestions for improvement are the development of skill oriented training programme, workshops, encouragement of good leadership in the group and constant guidance and support through the Commercial Banks, government and non government agencies is needed that leads finally to inclusive growth.

Micro Finance Institutions can also play an important role in development of microfinance sector

The group lending model which made many to commit suicide should be replaced with individual lending based on checking of credit worthiness of clients. Moreover , these MFIs can earn sufficient profit & can satisfy their clients, only if they are able to generate funds at lower rates of interest which is possible if they start accepting deposits instead of opting for Bank borrowing or market operations like IPO. They can also introduce some other insurance & health financial products to increase their operating profit.

There is a need to involve an informal micro financing through formal financial institutions

Majority of MFIs are not practicing the Knowledge Management Centre in their organization. It is advised them to develop such centre which would facilitate them with better results and they may get competitive advantages over their rivals or competitors. More active cooperation on the part of DRDAs, Blocks and Panchayats are also recommended for active supervision, nurturing, removing weakness, meeting timely microcredit and group requirements, ensures efficient functioning of the Self Help Groups and Women empowerment as well. There will be a win-win situation for both the MFIs and the manufacturers and both of them will be able to grow continuously over a period of time. The manufacturers will not escape from their liability of payment of interest and repayment of loans because they are the specialists in this area and they will not find any other means to earn their living. Also if the advances will be made to the manufacturers under Joint Liability Group (JLG) model the risk of default will be reduced. The MFIs can go for other modes of financing also for providing loans to the manufacturers to play safe. E.g. they can ask the manufacturers to submit the margin money with the company to get the loans. This margin may vary up to 50% of the total loans provided by the company as this will lead to better performance by the manufacturers and they will also utilize the money properly. There is need for insurance among low income households; it often is not translated into effective demand. Moreover, the demand is diverse in nature and it is determined by largely influenced by household's occupation and risk priorities.

Conclusion:

Most poor people manage to mobilize resources to develop their enterprises and their dwellings slowly over time. Financial services could enable the poor to leverage their initiative, accelerating the process of building incomes, assets and economic security. However, conventional finance institutions seldom lend down-market to serve the needs of low-income families and women-headed household. All MFIs need to work hard to build a common culture and mitigate the risk posed by overzealous loan officers. Yet shutting down an entire industry because of anecdotal evidence of occasional problems would be like closing all schools because a few teachers provide poor or misguided teaching to their students. With the mutual efforts of the MFI’s, self help groups, Govt. and the general public at large the micro finance sector can grow very fast and would be in a position to serve its inherent objectives well.

Micro insurance sector in India are to focus on the supply side factors like costs of market development, competition, incentives to insurers and intermediaries such as MFIs. Better product design, infrastructure to deliver the insurance product, wider awareness and information about insurance, customized products, expanding access to credit markets are some key areas for policy interventions for functioning of micro-insurance markets.

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