A STUDY ON MICRO FINANCE AND FINANCIAL INCLUSION

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ABSTRACT

Role of micro finance (MF) and micro financial institutions (MFIs) is crucial for organizing the poorer sections in rural and urban areas, to enable them to take up income generating activities, and cross the poverty line. Financial inclusion is one of the basic strategies for the uplift of the poor, and for improving their living standards. The article covers a wide variety of services falling under the purview of micro finance as distinguished from the limited coverage of micro credit, and points out the potential areas where penetration is still low. Apart from savings, and credit, which are well established through the involvement of NGOs and MFIs, low penetration areas are insurance and remittance services. Blending of MF strategies with the approaches for financial inclusion based on the recommendations of the Report of the Committee on Financial Inclusion (2008) becomes necessary to ensure the availability of basic financial services of formal financial institutions to the poor, including those in remote parts of the country.

INTRODUCTION

Often the term Micro Finance (mF or MF) is limited to the narrow definition of 'micro credit for micro enterprise or an economic activity of low investment'. Micro finance represents more dimensions than micro credit or a small quantum of loan. It also refers to a much wider range of financial products, such as safe savings, credit, insurance, pledge, payments and remittances, and pension. This distinction has at its heart, the need to highlight the importance of savings and other financial products, apart from loan to cater to the diverse financial services needed by the poor clientele. It is hoped that by ensuring safety, the savings habit, crucial towards economic uplift, among the weaker sections will be promoted, and the quantum of savings will be raised to higher levels. The Task Force on Supportive Policy and Regulatory Framework for Micro Finance (NABARD, 1999) has defined MF 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". While exclusively covering the poor, it lays emphasis on graduating borrowers from pre-micro enterprise (pre-me) stage to the post-me stage. This graduation is done through the support of financial and non-financial services. International Labour Organisation (ILO) terms MF as an economic development approach that involves providing financial services through institutions to low income clients. MF, thus, refers to the entire range of financial services, including skill up gradation, entrepreneurship development, and other business development services (BDS), rendered to the poor for enabling them to overcome poverty. Size and clientele are the two distinguishing features of MF. MF becomes distinct from other regular credit where not only the credit amount is small, and the clientele are poor, but also credit is provided with "a collateral substitute" instead of the traditional collateral; and non-financial services are also provided for increasing the productivity of credit

REVIEW OF LITERATURE

Dasgupta, 2005- In the self help group (SHG) mechanism, group guarantee facilitates the smooth recovery of loan to the banks / micro financial institutions. Non-financial services can include business development services, social activities, and development projects. Social activities of micro financial institutions can be one or more of services relating to health, education, sanitation, natural resource management, women empowerment, etc.

Vijay Mahajan and G. Nagasri, 1999- Micro finance refers to accessing financial services in an informally formal route, in a flexible, responsive, and sensitive manner which otherwise would not have been possible for the formal system to provide such services because of factors like high transaction cost emanating from low scale of operation, high turnover of clients, greater frequency of transaction, etc. The current literature on micro finance is also dominated by the positive linkages between MF and the achievement of the eight Millennium Development Goals (MDGs), envisaged by the United Nations for attainment by 2015. The Micro Credit Summit Campaign's 2005 Report and the Asian Development Bank in its theme paper on micro finance cite access to financial services as critical for eliminating poverty, and reaching the targets set for MDGs.

The term Micro Financial Institutions (MFIs) was defined by the NABARD Task Force (1999) as "those institutions which provide thrift, credit, and other financial services, and products of very small amounts mainly to the poor, in rural, semi-urban or urban areas, for enabling them to raise their income level, and improve living standards". The MFIs provide services, which can be broadly categorised as financial and non-financial nature. MFIs have come up in recent years, largely with the initiative of NGOs (non-governmental organisations) to fill the gap between demand and supply for micro finance. Formal institutions such as commercial banks, regional rural banks, and cooperative banks, which also make available small quantum of loans to the poor and other than poor clients are referred to as micro finance service providers. MFIs cater mainly or exclusively to the poor clientele in an informally formal route. The Micro Finance (Development and Regulation) Bill, 2007 of Government of India which is under the consideration of the Parliament defines the nature and quantum of assistance through micro finance "as providing financial assistance to an individual or an eligible client, either directly or indirectly through a group mechanism, for an amount not exceeding Rs.50,000 for all economic activities, including consumption purposes, and Rs.1.5 lakh for housing purposes".

Micro finance through the self help group (SHG) mechanism has grown rapidly in the country since late 1990s due to the following reasons: (i) ability to reach out to the poor, (ii) promise of financial sustainability, (iii) potential to build on traditional systems, (iv) provision of informal and flexible financial services to the poor meeting their modest consumption and livelihood needs, (v) the availability of better financial products as a result of experimentation and innovation, and (vi) provision of collateral–free micro credit to the poor.

FINANCIAL INCLUSION

Government of India constituted a Committee on Financial Inclusion under the chairmanship of C. Rangarajan in June 2006. The Committee submitted its interim report in February 2007, and the final report in January 2008. Based on the recommendations of the Committee, Government of India announced the creation of two separate funds with an overall corpus of Rs.500 crore each for financial inclusion. These are Financial Inclusion Fund (FIF), and Financial Inclusion Technology Fund (FITF). The Government has also declared its intention to convert the said Committee with suitable changes into a National Mission on Financial Inclusion (NaMFI), aiming at achieving universal financial inclusion within a specified time frame. The mission would aim at a target to provide comprehensive financial services, to at least 50 per cent of the financially excluded rural cultivator / non-cultivator households by 2012, and the remaining households to be covered by 2015. Based on the recommendations of the Committee, commercial banks including regional rural banks (RRBs) have been advised to add at least 250 rural household accounts every year at each of their rural and semi–urban branches, and also individuals such as retired bank officers, ex–servicemen, etc. to be appointed as business facilitators or business correspondents or credit counsellors. Furthermore, in order to strengthen the on-going financial inclusion, the Government advised all scheduled commercial banks to meet the entire credit requirements of SHG (self help group) members from 2007-08, namely, (a) income generation activities, (b) social needs like housing, education, marriage, etc., and (c) debt swapping (Reserve Bank of India, 2008).

The objective of the Financial Inclusion Fund (FIF) is to support "developmental and promotional activities" with a view to securing greater financial inclusion, particularly among weaker sections, low income groups, and in backward regions / hitherto unbanked areas. The fund, *inter alia*, would be used for (i) providing funding support for capacity building inputs to business facilitators and business correspondents; (ii) providing promotional support to institutions such as resource centres, farmers' services centres, and rural development and self employment training institutes to enable them to provide improved technical and financial services (including counselling) aimed at increasing technology adoption, effective management of assets, nurturing entrepreneurial capacity, and increasing financial education and literacy; (iii) providing funding support for promotion, nurturing, and credit linking of self help groups (SHGs); (iv) capacity building of personnel of NABARD, banks, post offices, state government departments, micro financial institutions (MFIs), NGOs, local level associations, members of SHGs / joint liability groups, among others; (v) supporting initiatives of local level associations / federations; and (vi) any other developmental and promotional interventions recommended by the advisory body for the FIF.

The objective of the Financial Inclusion Technology Fund (FITF) is "to enhance investment in information and communication technology (ICT)" aimed at promoting financial inclusion, stimulating the transfer of research and technology in financial inclusion, increase the technological absorption capacity of financial service providers / users, and encourage an environment of innovation and co-operation among the stakeholders. The Fund, *inter alia*, would be used for (i) encouraging user friendly technology solutions; (ii) providing financial support to technological solutions aimed at providing affordable financial services to the disadvantaged sections of the society; (iii) creating a common technology infrastructure with comprehensive credit information; (iv) funding support to technologies facilitating the documentation for processing of loans; (v) providing viability gap / pilot project funding for unproven but potential technological interventions; (vi) conduct of studies, consultancies, research, and evaluation studies relating to technological interventions for financial inclusion; (vii) promoting seminars, conferences, and other mechanisms relating to financial technological interventions; (viii) publication of financial inclusion technology literature, etc.; (ix) capacity building of personnel of all stakeholders; and (x) any other activity as may be approved by the Advisory Board (RBI, 2008).

Both the Funds were created in NABARD in 2008. The Government advised that for the year 2007-08, it was decided to initially contribute Rs.25 crore each in the two funds by the Central Government, Reserve Bank of India (RBI), and NABARD in the ratio of 40:40:20. The funding would be contributed in a phased manner over a maximum period of five years, keeping pace with the utilisation of funds. Depending on the outflow of funds, annual replenishments may be made by the Government, RBI, NABARD, and other stakeholders / institutions. It was also indicated that both the funds would be in operation until financial inclusion to the extent of 100 per cent of rural families in all the districts is achieved, over a period of five years from the date of commencement of the funds, or for such enhanced period, as may be decided by the Government.

A few of the other recommendations made by the Committee on Financial Inclusion (2008) are as follows:

i) Deepening the outreach of micro finance programme through financing of SHGs / joint liability groups (JLGs), and setting up a risk mitigation mechanism for lending to small and marginal farmers/ share croppers / tenant farmers through JLGs;

ii) Use of primary agricultural credit societies as business facilitators and business correspondents;

iii) Micro Finance – non–banking finance companies (MF – NBFCs) could be permitted thrift, credit and micro insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban, and urban areas. Such MF – NBFCs may also be recognises as Business Correspondents of banks for providing only savings and remittance services, and also act as a micro insurance agents.

iv) Opening of specialised MF branches / cells in potential urban centers for exclusively catering to MF and SHG-Bank linkage requirements of the urban poor. An enabling provision has been suggested in NABARD Act, 1981 permitting NABARD to provide MF services to the urban poor.

Branchless banking through business correspondents (BCs) has become important in the area of inclusive finance. The benefits of the model to the customers, include saving of their time and cost of travel to the branch, comfort in dealing with the BC as he/she is a familiar face, and convenience of transacting business practically any time of the day. The advantage for the BC is that it is an alternative source of income. The benefits for the bank are that they are able to reach the hitherto unreached segments, and mop up rural savings at lower transaction costs. Besides covering NGOs, MFIs (other than regular NBFCs), and other civil society organisations as intermediaries, retired bank employees, ex-servicemen, retired government employees, and section 25 companies (with some attendant restrictions) have been permitted by RBI to be appointed as BCs.

The Reserve Bank has undertaken a number of measures for bringing the financially excluded population into the structured financial system. Banks have been allowed to classify 100 per cent of the credit outstanding under general purpose credit cards and overdrafts up to Rs.25,000 (per account) granted against 'no frills' accounts in rural and semi-urban areas as indirect finance to the agriculture sector under priority sector. Banks have also been advised to set up financial literacy–cum–counselling centres. Financial literacy campaigns could enable consumers to choose from a myriad of financial products and their providers, provide individuals with the knowledge necessary to create household budgets, initiate savings plans, manage debt, and make strategic investment decisions for their future. In order to make financial inclusion more effective, banks would need to offer banking services much closer to the account holders apart from offering other services such as loan and insurance products. This would need to be done through a variety of channels by leveraging on technology and intermediaries. Banks also need to increase the banking outreach to the remote corners of the country, with affordable infrastructure, low operational costs, and use of technology, thereby making the small transactions economically viable.

FINANCIAL PRODUCTS AND SERVICES OFFERED BY MFIS

While MFIs are invariably involved in offering financial products and services, some of them are also involved in delivering non-financial services. The approaches adopted by them can be categorised mainly as two: the minimalist approach and the integrated approach. The minimalist approach MFIs tend to focus primarily on financial services, while MFIs taking an integrated approach complement their financial services with services of non-financial nature, such as business development services (BDS) or other social services such as health, education, women empowerment, etc. This section covers the prominent financial services provided by MFIs. Some of the services which have potential, but being practiced in a limited way in very few parts of the country are also covered. The micro finance services covered are credit, savings, insurance, remittance, and demand for MF in urban areas for self employment, housing, and shelter improvement.

MFIs focusing on the overall credit needs of the clients assess the overall creditworthiness of the client during their appraisal, and if they feel that the client has the capacity to repay the loan she/he may use it for various purposes, including for consumption and social needs. The MFIs believe that as long as they are able to recover the loan, the client should have the freedom to decide the purposes of the use of the amount. Timeliness, adequacy, and affordability are the main criteria kept in view while providing loan to the client. Other aspects that go with the main criteria are offering credit at the door step of the client with simple loan procedures, and without collateral. Individual loans are more prevalent with clients who generally need bigger size loans, and have the capacity to provide guarantee, and generate enough comfort to the MFI. If the loan is significantly larger, then MFIs also take some collateral security. Savings fall into two categories: compulsory and voluntary. In the group approach, savings are collected from individuals at regular intervals in the meetings of the group or directly from individuals, on a regular basis. Compulsory savings help MFIs to ascertain the genuine interest of the client in being associated with the MFI. In case of the SHG-Bank linkage model, six months of regular savings is stipulated as an essential condition for loan to be sanctioned by the bank to the SHG. Hence compulsory savings act as some sort of collateral. Peer pressure in the group facilitates smooth recovery of loan by the bank. Voluntary savings are those, which the clients decide to make because they have the funds, and out of their desire to deposit the savings.

Micro insurance has been gaining popularity in many regions, with the initiative of MFIs and NGOs. Insurance is a social security product, which can help the MFIs and the clients in mitigating their risk. MFIs earlier used to provide insurance in–house, but with formal insurance companies entering the field of micro insurance, and coming up with suitable products, in–house insurance has become less common. Instead, MFIs are now opting for the collaboration model. In this, the tripartite arrangement between the client, the insurance company, and the MFI is made, with MFI acting as an intermediary between the client and the insurance company. The claims are settled through the MFI. The MFI receives commission from the insurance company. The regulations of the Insurance Regulatory and Development Authority (IRDA), which have made it mandatory for insurance companies to cover rural and social sectors, have given a fillip to micro insurance in the country. Different purposes of micro insurance and the recommendation of the Committee on Financial Inclusion on micro insurance are covered later.

In urban areas, the demand for MF is for housing and shelter improvement as well as for purchase of consumer durables, and for self employment from the poorer sections in slums and other places. Quite apart from assigning much greater importance to wage employment in urban areas, self employment itself, whether in manufacture or services, is likely to exhibit a much greater diversity than in rural areas where a much smaller group of activities such as livelihood and petty trading often account for the majority of loans. Very often the demand in urban areas from the self employed such as flower or vegetable vendors, or pushcart vendors of food and snacks or those operating tea shops is for increased working capital for carrying on their business with a larger turnover.

MICRO INSURANCE POTENTIAL

The Committee on Financial Inclusion in its report (2008) observed that micro insurance should provide greater economic and psychological security to the poor, as it reduces exposure to multiple risks, and cushions the impact of a disaster. Micro insurance in conjunction with micro savings and micro credit could go a long way in keeping this segment away from the poverty trap, and would truly be an integral component of financial inclusion.

The Committee suggested that in order to economise on costs and to increase the outreach of micro insurance to the poor, the insurers need to utilise the existing government organisations and NGOs, having greater acceptability among the financially excluded. There is need to emphasise linking of micro credit with micro insurance. Further, as it helps in bringing down the inherent risk cost of lending, NABARD should be regularly involved in issues related to rural and micro insurance to leverage on its experience of being a catalyst in the field of micro credit. The Committee suggested that the technology platforms being envisaged to facilitate financial inclusion should enable micro insurance transactions also. Towards this end, there is a need to integrate various modules – savings, credit, insurance, *etc.* – into technology framework so that holistic inclusive efforts are possible in rural areas.

A few instances of micro insurance linked with micro credit services are found in some states with the initiative of some of the popular MFIs. SEWA Bank in Ahmedabad is prominent in this direction. Mainstream insurance providers such as Aviva Life Insurance, ICICI Lombard, and Max New York Life have displayed willingness to develop products suited to MFIs. Lombard's weather insurance scheme is an example of the recent movement towards insuring farm produce against the vagaries of monsoon. Tata AIG Life has plans to achieve 'break even' in the next ten years. MFIs can establish linkages with them to provide insurance cover to the poor. BASIX at Hyderabad, bought a bulk insurance policy from ICICI Lombard, and provided cover to groundnut and castor farmers in Andhra Pradesh and Karnataka through its Krishna Bhima Samruddi Local Area Bank. Micro insurance being a common product across a number of MFIs now, it is provided in collaboration with insurance companies. The problem is more acute in rural areas, where awareness is low. Can the group approach tried out in case of MF be suitable for micro insurance, if the tie up can be established, and whether MFIs if engaged in this field can become viable agents for delivering micro insurance as well? Regional experiences need to be reviewed periodically to ensure success.

CONCLUSION

The article presents a wide range of services provided to the poor by the micro finance (MF) sector, as distinguished from the limited scope of micro credit, and highlights potential areas, where penetration is still very low. The MF services listed are savings, credit, insurance, payments and remittance with focus on rural areas, and poorer sections of women in particular. The low penetration, but potential services in rural areas are insurance and remittance facilities. The demand for MF in urban areas for housing, shelter improvement, self employment, and purchase of consumer durables has also been pointed out. Recommendations of the Committee on Financial Inclusion (2008) on various aspects of financial inclusion, and the need to link the financial inclusion strategies with those of MF, including micro insurance have been dealt with in detail. Changing trends in the banking practices, including innovative approaches such as technological advances and role of business correspondents and business facilitators have been emphasised as part of the changing role of the formal financial system to meet the needs of financial inclusion, particularly in rural areas. The Financial Inclusion Fund and Financial Inclusion Technology Fund created in NABARD have an important role to play in facilitating the transformation process.

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