MICROFINANCE IN INDIA

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ABSTRACT

In a country like India where 70 percent of its population lives in rural area and 60 percent depend on agriculture (according to the World Bank reports), micro-finance can play a vital role in providing financial services to the poor and low income individuals. Microfinance is the form of a broad range of financial services such as deposits, loans, payment services, money transfers, insurance, savings, micro-credit etc. to the poor and low income individuals. The importance of micro-finance in the developing economies like India cannot be undermined, where a large size of population is living under poverty and large number of people does not have an access to formal banking facilities.

Microfinance is a form of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking. There are two broad approaches that characterize the microfinance sector in India is Self Help Groups (SHGs)-Bank linkage programme and Microfinance Institution (MFIs). In India microfinance is dominated by Self Help Groups (SHGs)-Bank linkage programme aimed at providing a cost effective mechanism for providing financial services to the unreached poor.

Keywords: *SHG (Self Help Group) , MFI(Microfinance Institution), World Bank, payment services, Money transfer*

INTRODUCTION

The concept of microfinance refers to provision of financial services to the poor through credits and deposits. The microfinance in India is gaining momentum for sustainable development. Microfinance is taken as an important tool for poverty alleviation and livelihood for the poor. It is also taken as a method for financial inclusion to improve sustainable development in the country. The innovation brought by Dr. Mohammad Yunus at Bangladesh which is currently existing as Grameen Model as created awareness to many countries and especially in India to make it as a way of eradicating poverty. The microfinance sector is currently undergoing into huge innovations and claiming to be an emerging sector especially creeping into the concept of fmancial inclusion.

DEFINITION

Asian Development Bank defines Microfinance as the provision of broad range of services such as savings, deposits, loans, payments, services, money transfers and insurance to the poor and low income householders and their micro enterprises.

Microfinance Development Regulation Bill defines Microfinance as the provision of fmancial services and insurance services to an individual or an eligible client directly or through group mechanism for an amount not exceeding fifty thousand in aggregate per individual for small and tiny enterprise, agricultural, allied activities or an amount not exceeding one lakh fifty thousand in aggregate per individual for housing or other prescribed purposes.

The history of microfinancing can be traced back as long to the middle of the 1800s when the theorist Lysander Spooner was writing over the benefits from small credits to entrepreneurs and farmers as a way getting the people out of poverty. But it was at the end of World War II with the Marshall plan the concept had an big impact.

HISTORY OF THE MICROFINANCE

The today use of the expression micro financing has it roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Mohammad Yunus, where starting and shaping the modern industry of microfinancing. Another pioneer in this sector is Akhtar Hameed Khan. At that time a new wave of microfinance initiatives introduced many new innovations into the sector. Many pioneering enterprises began experimenting with loaning to the underserved people. The main reason why microfinance is dated to the 1970s is that the programs could show that people can be relied on to repay their loans and that it´s possible to provide financial services to poor people through marketbased enterprises without subsidy. Shorebank was the first microfinance and community development bank founded 1974 in Chicago .

An economical historian at Yale named Timothy Guinnane has been doing some research on Friedrich Wilhelm Raiffeisen´s village bank movement in Germany which started in 1864 an by the year 1901 the bank had reached 2million rural farmers. Timothy Guinnane means that already then it was proved that microcredit could pass the two tests concerning peoples paybackmoral and the possibility to provide the financial service to poor people.

Another organization, The caisse populaire movement grounded by Alphone and Dorimène Desjardins in Quebec , was also concerned about the poverty, and passed those two tests. Between 1900 to 1906 when they founded the first caisse, they passed a law governing them in the Quebec assembly , they risked their private assets and must have been very sure about the idea about microcredit.

Today the World Bank estimates that more than 16 million people are served by some 7000 microfinance institutions all over the world. CGAP experts means that about 500 million families benefits from these small loans making new business possible. In a gathering at a Microcredit Summit in Washington DC the goal was reaching 100 million of the world´s poorest people by credits from the world leaders and major financial institutions.

The year 2005 was proclaimed as the International year of Microcredit by The Economic and Social Council of the United Nations in a call for the financial and building sector to "fuel" the strong entrepreneurial spirit of the poor people around the world.

The International year of Microcredit consists of five goals:

- Assess and promote the contribution of microfinance to the MFIs
- Make microfinance more visible for public awareness und understanding as a very important part of the development situation
- The promotion should be inclusive the financial sector

- Make a supporting system for sustainable access to financial services
- Support strategic partnerships by encouraging new partnerships and innovation to build and expand the outreach and success of microfinance for all

The economics professor Mohammad Yunus and the founder of Grameen Bank were awarded the Nobel Prize 2006 for his efforts. The press release from nobelprize.org states:

"The Norwegian Nobel Committee has decided to award the Nobel Peace Prize for 2006, divided into two equal parts, to Muhammad Yunus and Grameen Bank for their efforts to create economic and social development from below. Lasting peace can not be achieved unless large population groups find ways in which to break out of poverty. Micro-credit is one such means. Development from below also serves to advance democracy and human rights. Muhammad Yunus has shown himself to be a leader who has managed to translate visions into practical action for the benefit of millions of people, not only in Bangladesh , but also in many other countries. Loans to poor people without any financial security had appeared to be an impossible idea. From modest beginnings three decades ago, Yunus has, first and foremost through Grameen Bank, developed micro-credit into an ever more important instrument in the struggle against poverty. Grameen Bank has been a source of ideas and models for the many institutions in the field of micro-credit that have sprung up around the world.

Every single individual on earth has both the potential and the right to live a decent life. Across cultures and civilizations, Yunus and Grameen Bank have shown that even the poorest of the poor can work to bring about their own development.

Micro-credit has proved to be an important liberating force in societies where women in particular have to struggle against repressive social and economic conditions. Economic growth and political democracy can not achieve their full potential unless the female half of humanity participates on an equal footing with the male.

Yunus's long-term vision is to eliminate poverty in the world. That vision can not be realised by means of micro-credit alone. But Muhammad Yunus and Grameen Bank have shown that, in the continuing efforts to achieve it, micro-credit must play a major part."

MICRO – FINANCE IN INDIA

In early 1980's, the existing banking policies, procedures and systems were not suited to meet the requirements of poor. For borrowings poor people usually resort to unorganized sector. NABARD recommended that alternative policies, systems and procedures should be put in use to save the poor from the clutches of moneylenders. Thus microfinance was introduced in banking sector.

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to the poor and low income households and their micro-enterprises. Microfinance is defined as "Financial Services (savings, insurance, fund, credit etc.) provided to poor and low income clients so as to help them raise their income, thereby improving their standard of living".

Micro-financing is regarded as a tool for socio-economic up-liftment in a developing country like India. It is expected to play a significant role in poverty alleviation and development. Mohammed Yunus was awarded the Noble Prize for application of the concept of microfinance, with setting up of the Grameen Bank in Bangladesh. Micro credit and microfinanceare different. Micro credit is a small amount of money, given as a loan bya bank or any legally registered institution, whereas, Microfinanceincludes multiple services such as loans, savings, insurance, transferservices, micro credit loans etc.

FEATURES OF MICROFINANCE

- It is an essential part of rural finance.
- It deals in small loans.
- It basically caters to the poor households.
- It is one of the most effective and warranted PovertyAlleviation Strategies.
- It supports women participation in electronic activity.
- It provides an incentive to grab the self employment opportunities.
- It is more service-oriented and less profit oriented.
- It is meant to assist small entrepreneur and producers.
- Poor borrowers are rarely defaulters in repayment of loans as they are simple and God-
- fearing.
- India needto establish several Microfinance Institutions.

Role and Significance of Micro-finance

Micro-finance contributes to social and economic development of the nation in the following ways:

1. Poor people cannot access banking services due to their meagre income and inability to handle banking procedures and documentation. It is through micro-finance that a wide range of financial services such as deposits, loans, payment services, money transfers and insurance can be provided to the poor and low income households and their micro-enterprises.
2. Micro-finance institutions, through their NGOs, develop saving habits among poor people. The financial resources generated through savings and micro credit obtained from banks are utilised to provide loans and advances to the members of the Self Help Groups (SHGs). Thus, microfinance institutions help in mobilisation of savings and using the same for the welfare of its members.
3. Loans from the normal banking system require collateral or counter guarantee which poor people cannot offer and therefore, cannot get loan. Again, high interest rates and procedural and documentation formalities act as a deterrent to poor people accessing banks for loans. Microfinance does away with all these obstacles and provides finance to rural and poor population on easy terms.
4. Micro-finance allows the poorer sections of the society to get loans at cheaper rates which helps them to start their businesses on a small scale, grow their business and get out of poverty and be independent and self-sufficient. It helps in creating long-term financial independence among the poorer sections of the society and therefore, promotes self-sufficiency among them.
5. Micro-finance is provided through the intermediation of Self Help Groups (SHGs). More than 50% of the Self Help Groups (SHGs) are formed by women. Now, they have greater access to financial and economical resources. It is a step towards greater security for women. Thus, micro-finance empowers poor women economically and socially.

MODELS OF MICROFINANCE

Grameen Model

It is one of the successful model of microfinance. The model initiated through a group of five members. A compulsory contribution will made to group savings and insurance fund. Each member maintains their individual savings and loan account in the bank after contributing to the group, the members will receive individual loan from the bank. The responsibility of repayment lies on the individual. Loans are provided for a period of 6 months to 1 year and the repayment has to be made weekly. A period visit is conducted by the bank officials to monitor the records and the financial transactions. This model is being adopted in 40 countries in Asia, Africa and Latin America.

Joint Liability Group Model

The members in this groups are from 4 to 10 who form a group. The group members can avail bank loan against mutual guarantee and there is no condition of their own saving fund. All members jointly are in a contract making jointly liable for repayment of loans taken by all members. This model is followed in many microfinance enterprises in India. The progress of empowerment in this model are very limited. Many other countries are also following this model.

Individual Lending Model

The individual can get loans by themselves without being affiliated in group. Financial institutions have to closely monitor the status of individual on the status of borrowings. It is most successful for larger, urban – based, production – based business. This model is used in many developing countires such as Egypt, Indonesia, Senegal, India.

The Group Approach

The entire financial process in group approach is monitored by financial institutions The activities such as savings, loans, repayments are managed at group level. There may be 10 – 20 members who will have regular savings which will be pooled up as common fund. The loans are issued by financial institutions in the name of the group. The repayment schedule is made by the financial institutions to the group and field staff periodically visit and monitor the process of repayment. In India this method is known as SHG Bank Linkage Programme which is a very popular model being followed.

Village Banking Model

This model was developed in Bolvia during 1980s by the Foundation for International Community Assistance. A village bank is developed by forming 30 to 100 members who have low income and seek to improve their livelihood. The MFIs lend capital to the bank and in turn which lends money to the members. Loans amounts are linked to the aggregate amount saved by individual bank members. Loans are paid in weekly installments.

SELF HELP GROUP MODE

The SHGs are informal and homogenous groups of 10 to 20 members each. These groups are formed by bank officials, NGOs and other institutions at the village level. The group is given a name and each group has a leader, cashier and secretary being elected by the group members to manage the group affairs. The members indulge in voluntary savings on regular basis. The groups members decide mutually on the amount of savings to be deposited in the group account. These amount are used for rotational internal loan on low interest basis. 3

REGULATION OF MICROFINANCE INDUSTRY

The recent crisis in Andhra Pradesh in 2010 has made the whole microfinance industry into a down turn due to over indebtness This paved way to form Malegam Committee by Reserve Bank of India The introduction of Andhra Pradesh Microfinance Ordinance 2010 which restricted microfinance operations leading to drastic drop in loan repayments. The Low repayment rates made the microfinance institutions to have heavy losses. In order to

solve the situation the Reserve Bank of India appointed a sub committee known as Malegam Committee. The committee analyzed the flaws on collection practices, interest rates. The Malegam Committee gave recommended regulations in 2011 and these regulations were
accepted by RBI. The regulations has been amended and drafted to Microfinance Institutions (Development and Regulation) Bill 2011 which provides regulatory structure for microfinance institutions

Microfinance in India – 2016 Outlook

What is in store for Indian Microfinance Companies for the year 2016.

The year 2016 promises to be full of developments that could propel India's microfinance sector past the heights that it touched in 2010.

In 2010, Indian MFI's had to face a backlash from loan borrowers and politicians. There was large scale default on loans because of non-repayment by clients which caused the top 5 MFI's to incur heavy losses. Since then MFI's have reigned in their growth and have adopted practices that ensure there is no multiple lending. They have also constituted a self regulatory organizationcalled MFIN (Microfinance Institutions Network) which addresses grievances of microfinance clients and ensures the MFI's are sticking to their code of conduct.

Given below is the 2016 Outlook for Microfinance companies in India

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- with for the next 2-3 years. MFI's are expected to grow by 30-40% annually which means the top MFI's in India could double in size over the next few years.
- The asset quality indicators for most MFI's are good though political risk remains, the North Indian state of Uttar Pradesh seem to have over-heated according to some news reports.However unlike 2010, this time MFI's are using credit bureaus to prevent multiple lending.
- More than 8 MFI's have been given bank licenses and some of them would begin operations this year. Bandhan Financial Services was the first to transform into a full fledged bank.
- Esaf Microfinance, Equitas, Suryoday Microfinance and Ujjivan Financial Services are looking to offer shares to the public through IPO's (Initial Public Offers), their issues could hit the markets within the next 6 months.
- Private Equity investors continue to pour in funds into private unlisted microfinance companies. Many MFI's have also raised substantial amounts through loan securitization which shows that banks have once again reposed their confidence in this sector.

- During the FY 2015-16 , the credit ratings outlook for more than 12 microfinance institutions was upgraded. This shows the sector has fully recovered from the setbacks it had faced.
- Many microfinance companies have taken loans from MUDRA. The launch of MUDRA has helped MFI's to refinance their loans easily.
- Microfinance has shed it's non-profit character. In the last decade, microfinance was the domain of NGO's but the regulations introduced by RBI has totally altered the character of the organizations disbursing loans. Since most NGO's could not meet the stringent financial adequacy requirements, NBFC's now account for more than 90% of the micro-lending taking place in the country.

These remain the highlights of this year and going forward one can expect more good news to flow from the sector. The government of India's focus on financial inclusion through Jan Dhan Yojana has also benefited MFI's enormously as they can now directly disburse money into bank accounts. Though it is too early to pass judgement on the scheme, most observers believe the real benefits will accrue over the entire decade.

What is your view of the microfinance sector in India ? If you are an employee of a microfinance company do let us know about what you think about the internal practices at your organization in the comments below.

CONCLUSION

Based on this paper Microfinance Play crucial role in India microfinance into urban sector to promote rural marks and provide better, speedy and affordable financing schemes. Infotech application in microfinance is laudable and with emerging computer and communication technologies, it can be made as simple tool for rural folks to adopt and availed the finance for the proposed project to make the rural economy a dream. So the rural economy can definitely contribute to the growth the of national economy with the adoption of mixing Infotech with microfinance

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