

# MICRO FINANCE

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## Introduction

Microfinance is also called microcredit, is a type of banking service which offers poor people access to basic financial service such as loan, saving, money transfer services and micro insurance. While institutions participating in the area of microfinance are most often associated with lending (microloans can be anywhere from Rs. 10000 to Rs 15, 00,000), many offer additional services, including bank accounts and micro-insurance products, and provide financial and business education.

The type of financial needs of any person are as below

- **Lifecycle Needs:** such as weddings, funerals, childbirth, education, homebuilding, widowhood, old age.
- **Personal Emergencies:** such as sickness, injury, unemployment, theft, harassment or death.
- **Disasters:** such as fires, floods, cyclones and manmade events like war or bulldozing of dwellings.
- **Investment Opportunities:** expanding a business, buying land or equipment, improving housing, securing a job (which often requires paying a large bribe), etc.

Many microfinance institutions (MFIs) focus on helping women in particular.

Microfinancing organizations support a wide range of activities, ranging from business start-up capital to educational programs that allow people to develop the skills necessary to succeed as an entrepreneur. These programs can focus on such skills as bookkeeping, cash flow management and even technical or professional skills. Unlike typical financing situations, in which the lender is primarily concerned with the borrower having enough collateral to cover the loan, many microfinance organizations focus on helping entrepreneurs succeed.

## History of Micro-Finance across world

Microfinance is not a new concept: Small operations have existed since the 18th century. The first occurrence of micro lending is attributed to the Irish Loan Fund system, introduced by Jonathan Swift, which sought to improve conditions for impoverished Irish citizens.

But in its modern form, microfinancing became popular on a large scale in the 1970s. The first organization to receive attention was the Grameen Bank, which was started in 1976 by Muhammad Yunus in Bangladesh. On top of providing loans to its clients, the Grameen Bank also suggests its customers subscribe to its "16 Decisions," a basic list of ways the poor can improve their lives. The "16 Decisions" touch on a wide variety of subjects ranging from a request to stop the practice of issuing dowries upon a couple's marriage to ensuring drinking water is kept sanitary. In 2006, the Nobel Peace Prize was awarded to both Yunus and the Grameen Bank for their efforts in developing the microfinance system.

## In India

India's SKS Microfinance also serves a large number of poor clients. Formed in 1998, it has grown to become one of the biggest microfinance operations in the world. SKS works in a similar fashion to the Grameen Bank, pooling all borrowers into groups of five members who work together to ensure loan repayment.

## Benefits of Microfinance

The World Bank estimates that more than 500 million people have directly or indirectly benefited from microfinance-related operations. The International Finance Corporation (IFC), part of the larger World Bank Group, estimates that more than 130 million people have directly benefited from microfinance-related operations as of 2014. However, these operations are only available to approximately 20% of the 3 billion people who qualify as part of the world's poor.

In addition to providing microfinancing options, the IFC has assisted developing nations in the creation or improvement of credit reporting bureaus in 30 nations. It has also advocated for the addition of relevant laws governing financial activities in 33 countries.

The benefits of microfinance extend beyond the direct effects of giving people a source for capital. Entrepreneurs who create a successful business create jobs, trade and overall economic improvement within the community. Empowering women in particular, as many MFIs do, leads to more stability and prosperity for families

## Evolution Of Microfinance In India

The NABARD has successfully spearheaded the microfinance programme through partnership with various stakeholders like non-governmental organisations (NGOs), banks, cooperatives, etc, in the formal and informal sector, with support from both the government of India (GOI) and the Reserve Bank of India (RBI) since the early 1990s. The SHG-bank linkage programme . The SHG-bank linkage programme (BLP) was launched by NABARD as a pilot project in 1992 against the backdrop of a huge banking structure unable to adequately address the microcredit needs of the poor.

## Strength

### 1. Microfinance and Social Empowerment

The SHG-BLP itself has had a profound social impact. A number of studies conducted on the effectiveness of the programme, have highlighted its impact on the social empowerment process. Important findings with respect to the SHG programme are:

- It has enabled households to spend much more on education than non-client households. Families participating in the programme have reported better school attendance and lower dropout rates.
- It has empowered women by enhancing their contribution to household income, increasing the value of their assets and generally by giving them better control over decisions that affect their lives.
- In certain areas, microfinance has reduced child mortality, improved maternal health and the ability of the poor to combat disease through better nutrition, housing and health – especially among women and children.

- It has contributed to reduced dependency on informal moneylenders and other non-institutional lenders in rural areas.

## 2. Microfinance and Economic Growth

Economic growth requires many things from relatively stable governments to alleviation of poverty to the creation of a formal business sector to access to clean water, education, and healthcare. Long term growth can be achieved by putting an emphasis placed on improving overall quality of life, Public goods are missing from many of the small villages and poor slums in which microcredit is extended. Lack of safe wells, paved roads, and so on, limits the growth that successful and entrepreneurial microcredit borrowers can experience.

## Microfinance Institutions

A microfinance institution (MFI) is an organization that provides microfinance services. MFIs range from small non-profit organizations to large commercial banks.

Historical context can help explain how specialized MFIs developed over the last few decades. Between the 1950s and 1970s, governments and donors focused on providing subsidized agricultural credit to small and marginal farmers, in hopes of raising productivity and incomes. During the 1980s, micro-enterprise credit concentrated on providing loans to poor women to invest in tiny businesses, enabling them to accumulate assets and raise household income and welfare. These experiments resulted in the emergence of nongovernmental organizations (NGOs) that provided financial services for the poor. In the 1990s, many of these institutions transformed themselves into formal financial institutions in order to access and on-lend client savings, thus enhancing their outreach.

NABARD is an apex involved in refinancing credit needs of major financial institutions in the country engaged in the offering Financial assistance to agriculture and rural development operations and programmes , is undertaking and sharing with the RBI certain supervisory functions in respect of Co-operative banks and regional rural banks such as :

1. Inspection of RRBs and Co-operative Banks under the provisions of The Banking Regulation Act , 1949.
2. Inspection of State Cooperative Agriculture and Rural Development banks and apex non-credit cooperative societies on a voluntary basis.
3. Portfolio inspections , system study and off-site surveillance of Co-operative Banks and RRBs.
4. Recommendations to RBI on opening of new branches by State Cooperative Banks and RRBs.
5. Administering the Credit Monitoring Arrangements in the State Cooperative Banks, District Central banks.

The day to day functioning of the the supervised banks is being monitored through various statutory returns prescribed by the RBI/NABARD including OSS returns.

## REGULATORY FUNCTIONS:

1. The Banking Regulation Act , 1949empowers NABARD to undertake inspection of the RRBs and Co-operative banks .

2. Any RRB or Co-operative banks taking permission from RBI for opening new branches will have to obtain recommendation of NABARD.

3. RRBs and Co –operative are required to file returns and documents with the NABARD.

It has been entrusted with the statutory responsibility of the conducting responsibility of con

Ducting inspections of the State Cooperatives Banks, District Central Cooperative Banks and regional Rural Banks under the provisions of The Banking Regulation Act , 1949. In addition it conducts periodic inspections of state level co-operative institutions on the voluntary basis.

## **MICRO-FINANCE RBI'S APPROACH**

Banks were advised to consider the lending to SHGs as part of their mainstream credit operations , to identify branches with the potential to link with the SHGs and provide the necessary support services to such branches with the potential to link with the SHGs and provide the necessary services to such branches , while including the SHG lending within their service area plan .

Furthermore, subsequent to the Monetary and Credit Policy announcement for 1999-2000, banks were advised that interests rates applicable to loans given by banks to micro credit organizations or by the micro credit organizations to SHGs /member beneficiaries would be left to their discretion . Also the SHGs were free to decide on the interest rate to be charged their members , provided the rate of interest was not excessive.

## **Policy Initiatives by the Reserve Bank**

1. In January 1993, SHGs, registered or unregistered were allowed by the Reserve Bank to open savings bank account with banks. Further, to study the potential of the micro finance movement, the Reserve Bank constituted in 1994 a 'Working Group on NGOs and SHGs' (Chairman: Shri S.K. Kalia). Based on its recommendations, banks were advised, inter alia, that financing of SHGs should be included by them as part of their lending to the weaker sections and that SHG lending should be reviewed at the State level banker's committee (SLBC) level and by the banks at regular intervals.

2. To further promote the SHG momentum in the country, banks were advised by the Reserve Bank in 1998 that SHGs which were engaged in promoting the savings habits among their members would be eligible to open savings bank accounts and that such SHGs need not necessarily have availed of credit facilities from banks before opening savings bank accounts. Subsequent to the Monetary and Credit Policy announcement for the year 1999-2000, banks were also advised that interest rates applicable to loans given by banks to micro credit organizations or by the micro credit organizations to SHGs/ member beneficiaries, would be left to their discretion.

3. A Task Force on Supportive Policy and Regulatory Framework for micro finance was set up by NABARD in 1999 of which the Reserve Bank was a member. The Task Force looked into the entire gamut of issues related to micro finance, particularly regulatory issues. Recognizing the growing importance of micro finance, the Reserve Bank constituted a micro credit special cell in the Bank in 1999 to suggest measures for mainstreaming micro credit and accelerating flow of credit to MFIs. The special cell has since been converted into a micro finance and financial inclusion division in the Reserve Bank.

4. Several non-banking finance companies (NBFCs) and residuary non-banking companies (RNBCs) also started entering the micro finance sector, gradually recognising the potential in the sector. In order to further facilitate the process, in January 2000, all NBFCs and RNBCs were advised by the Reserve Bank that those NBFCs which were engaged in micro financing activities, licensed under Section 25 of the Companies Act, 1956, and which were not accepting public deposits were exempted from the purview of Sections 45-IA (registration), 45-IB (maintenance of liquid assets) and 45-IC (transfer of a portion of profits to Reserve Fund) of the Reserve Bank of India Act, 1934.

5. Based on the reports of the special cell constituted in the Reserve Bank and the Task Force on Supportive Policy and Regulatory Framework, the Reserve Bank issued comprehensive guidelines to banks in February 2000 for mainstreaming micro credit and enhancing the outreach of micro credit providers. These guidelines, inter alia, stipulated that micro credit extended by banks to individual borrowers directly, or through any intermediary, would from then onwards be reckoned as part of their priority sector lending. Banks were given freedom to formulate their own model/s or choose any conduit/intermediary for extending micro credit. Banks were also permitted to prescribe their own lending norms so as to provide maximum flexibility with regard to micro lending. Such credit was to cover not only consumption and production loans for various farm and non-farm activities of the poor, but also include their other credit needs. Banks were asked to delegate adequate sanctioning powers to branch managers and to keep the loan procedures and documents simple for providing prompt and hassle free micro credit.

6. The rapid development of the sector necessitated addressing the various issues associated with the sector. In October 2002, the Reserve Bank set up four informal groups to look into issues relating to: (i) structure and sustainability; (ii) funding; (iii) regulations; and (iv) capacity building of micro finance institutions. Taking into consideration the recommendations of the groups, banks were advised that they should provide adequate incentives to their branches for financing the SHGs and that the group dynamics of working of the SHGs should be left to them.

7. Based on the recommendations of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Chairman: Prof. V S Vyas), which submitted its final report in June 2004, it was announced in the Annual Policy Statement for the year 2004-05 that in view of the need to protect the interest of depositors, MFIs would not be permitted to accept public deposits unless they complied with the extant regulatory framework of the Reserve Bank. However, as an additional channel for resource mobilisation, the Reserve Bank in April 2005 enabled NGOs engaged in micro finance activities to access the external commercial borrowings (ECBs) up to US\$ 5 million during a financial year for permitted end use, under the automatic route.

8. In order to examine issues relating to rural credit and micro finance, an internal group (Chairman: Shri H.R. Khan) was set up in 2005. Based on the recommendations of the group and with the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, banks were permitted in January 2006 to use the services of NGOs/SHGs, MFIs (other than NBFCs) and other civil society organisations as intermediaries in providing financial and banking services through business facilitator and business correspondent models.

9. All Regional Directors of the Reserve Bank were advised in April 2006 that whenever issues relating to micro finance were noticed in the areas under their jurisdiction, they may offer to constitute a coordination forum comprising representatives of SLBC convenor banks, NABARD, SIDBI, State Government officials, and representatives of MFIs (including NBFCs) and NGOs/SHGs to facilitate discussion on the issues affecting the operations in the sector and find local solutions to the local problems.

10. In May 2006, a joint fact-finding study was conducted by Reserve Bank and a few major banks. It was observed during the study that some of the MFIs financed by banks or acting as their intermediaries/partners were focussing on relatively better banked areas and trying to reach out to the same set of poor, resulting in multiple lending and overburdening of rural households. Further, many MFIs supported by banks were not engaging themselves in capacity building and empowerment of the groups to the desired extent and banks did not appear to be engaging them with regard to their systems, practices and lending policies with a view to ensuring better transparency and adherence to best practices. Guidelines were, therefore, issued to banks in November 2006, advising them to take appropriate corrective action.

11. The Union Budget for the year 2008-09 announced that banks would be encouraged to embrace the concept of total financial inclusion. The Government would request all scheduled commercial banks to follow the example set by some public sector banks and meet the entire credit requirements of SHG members, namely: (a) income generation activities; (b) social needs like housing, education, marriage; and (c) debt swapping. Consequent upon this, in April 2008, banks were advised by the Reserve Bank to meet the entire credit requirements of SHG members, as envisaged in the Union Budget.

### Initiative by SBI Microfinance

- Formation of self help groups
- Wholesale lending
- Project Uptech
- Started in 1988 for technological upgradation in small and medium scale industries to make them more competitive.
- SBI LIFE 'SHAKTI'
- Insurance for rural womens who are part SHGs.
- Sahayog niwas
- To facilitate housing for SHG members. This scheme was extended to members of SHGs in semi-urban and rural areas
- AGRI SBU
- Contract farming
- KISAN CREDIT CARDS

## Conclusion

Currently the Micro Finance sector in India stands clearly divided into three segments:

- Slow growing, informal community based.
- Moderately growing not for profit
- Fast growing, regulated and commercial.

First of all, microfinance donors should focus their support on (and encourage) MFIs who operate in countries who are making consistent efforts to improve regulation, institutions, and legal systems. If governments of

developing countries are looking to lead their countries out of poverty, perhaps this might create incentives for governments to increase transparency and regulatory systems.

Secondly, MFIs need to rethink their target recipients. This is a more difficult way of handling microfinance. Yes, at first glance it may seem unfair to stop lending to poorest people who need it the most, but at a closer look it becomes clear that these people are not benefiting from their loans long term, or making business ventures that are sustainable. The more well off, who can still benefit from a microcredit loan to expand their business, buy more equipment, and employ more people, should be the main recipients of loans. These types of enterprises have the capacity for self-sustainability and revenues. Businesses under this category include (but is not limited to) those that have steady markets, some kind of office to operate out of, and room for expansion. More formal sector businesses such as these will create more growth and development than loans to informal sector businesses will.

Thirdly, using microfinance to increase access to public goods is an innovative and new way of improving quality of life for people. For instance, MFIs could offer low interest rates on village loans that will be used to build a well or a small school. While these loans would be larger and probably riskier, the condition of group lending makes it feasible. Arrangements could be made for urban districts interested in public good improvements. Default would cause the village or district to forego monies for future improvements. With this incentive, members of the group are keen on monitoring their fellow members and ensuring that everyone involved makes their repayments. While, such projects would certainly be more complicated than basic microfinance loans, perhaps that is the key to paving the way toward growth.

It is necessary to recognize that we in India have to focus on extending financial services to both rural and urban areas to ensure the financial inclusion of all segments of the population.

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