Microfinance in India Long Way to go

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Abstract

The paper throws light on microcredit in India and under given circumstances it would survive or not. It started as small groups formed to help themselves or the self help groups. One of the benefits is that it is very accessible. Banks don't provide loans to those with little to no assets, and generally don't give small size loans. The borrowing increased year after year and low income groups were supported as much as possible. There are many challenges within microfinance initiatives which may be social, financial, administrative and political. Here, some community members may cheat poorer or less-educated borrowers. But increasing default cases alarmed Microfinance Institutions to get hold of flaws in the system. Microfinance Institutions (Development and Regulation) Bill 2012 was introduced with a view to monitor the sector. The Bill was needed to strengthen the regulatory framework and consumer protection norms of the microfinance industry in India. An ordinance was made after a series of suicide incidents as a result of abusive practices of MFIs such as charging high interest rates, adopting coercive collection practices and lending aggressively beyond the repayment capacity of the borrowers rather than helping the poor get out of poverty. Policy makers must make strategies to help MFIs and borrowers as well. Repayment is less because of the loopholes in the lending procedures. Hopefully Standing Committee on Finance pays sufficient attention to these critical issues.

Keyboard: Microfinance, Standing Committee, Microfinance Institutions (Development and Regulation) Bill 2012, loans, regulatory framework

Introduction

Microfinance (also known as microcredit) is a variety of financial services that target low-income clients. Since the clients of microfinance institutions (MFIs) have lower incomes and often have limited access to other financial services, microfinance products tend to be for smaller monetary amounts than traditional financial services. These services include loans, savings, insurance, and remittances. Microloans are given for a variety of purposes, frequently for microenterprise development. The diversity of products and services offered reflects the fact that the financial needs of individuals, households, and enterprises can change significantly over time, especially for those who live in poverty. "There is no banking facility present in remote areas and therefore, these companies can play a major role in providing financial services in these areas and to the last man in the society,"[1]

Evolution of Microfinance

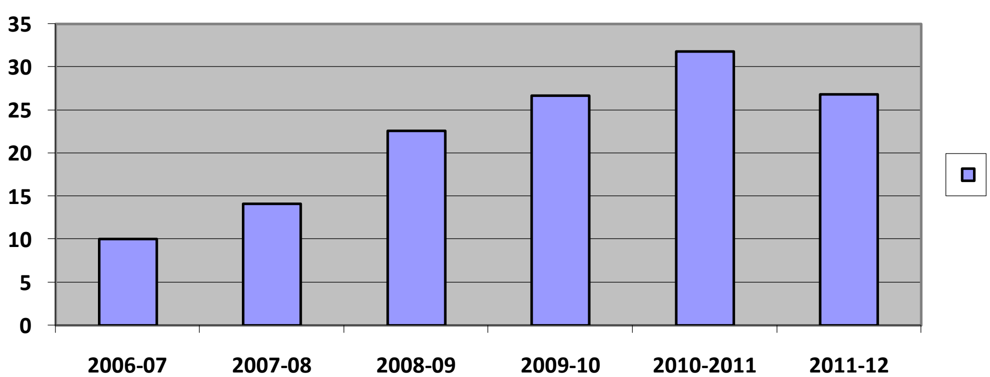
Lower income group needs cash and hence save in highly liquid assets like jewelry, live stock etc. These assets are both the livelihood of the poor and their savings. If they do not sell the asset, they will not be able to repay the loans and if they did, they would not have a livelihood. Therefore, Non-governmental Organisations start the movement in a micro level to the financial needs of the poor. The micro loans are given to these people and they are allowed the freedom to choose a livelihood.

Microfinance started in India sometime around 1980. It started as small groups formed to help themselves or the self help groups (SHG). Slowly the movement picked up momentum and national bodies like the Small Industries Development Bank of India (SIDBI) and the National Bank for Agriculture and Rural Development (NABARD) started financing on micro level. They have been devoting significant time and financial resources to microfinance. The table below shows client outreach of MFIs from year 2006 to 2012

Table 1: Number of Borrowers in MFIs in India

Year	No. of Borrowers (In Millions)
2006-07	10
2007-08	14.1
2008-09	22.6
2009-10	26.7
2010-11	31.8
2011-12	26.8

*Source: Puhazhendhi, Venugopalan: "***Microfinance India***: State of the Sector Report 2012", Sage Publications India, 2013 p. 4*

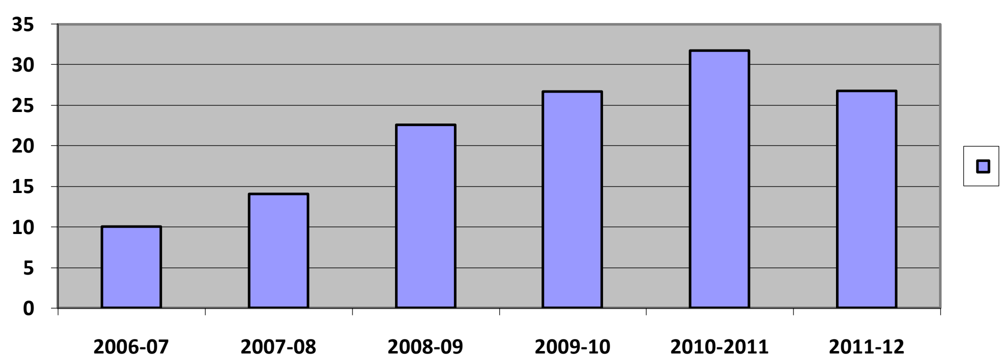


Above figures in table shows that number of borrowers lending money from MFIs has been continuously growing since year 2006 till 2010-11. This graph substantially declined in the year 2011-12. "According to Microfinance State of the Sector 2011 report, MFIs have reached 31.4 million clients all over India today. Andhra Pradesh has the highest concentration of microfinance operations with 17.31 million SHG members and 6.24 million MFI clients. The total microfinance loans in Andhra Pradesh including both SHGs and MFIs stood at Rs.1, 57,692 million with average loan outstanding per poor household at Rs. 62,527 which is the highest among all the states in India"[2]

Table 2: Size of loan provided by MFIs in India

Year	Loan Size (In Rs. Billions)
2008	4223
2009	5192
2010	6870
2011	6779
2012	7803

*Source: Puhazhendhi, Venugopalan: "***Microfinance India***: State of the Sector Report 2012", Sage Publications India, 2013 p. 5*



Above figures in table shows that money borrowed from MFIs has been continuously growing since year 2008 till 2010. This graph slightly declined in the year 2011 and increased in the year 2012. The different financial systems are not mutually exclusive and in practice entrepreneurs may use several methods of finance at once or combine them. A single source of finance is not sufficient enough to cater needs of a family. Microfinance sector is unable to meet and which are catered for more appropriately by informal sources. There is a major problem of debt repayment which directly cause of the credit institution, the implementation of credit enforcement mechanisms such as denial of future credit to a defaulter or whole group is necessary for an institution to succeed. Credibility needs to be established from both borrowers' and financers' side. Without infrastructure and access to markets, there is little scope for loan default management. There should be an arrangement that ensures that loans are not used for purposes they are not meant for if borrowers' actions are to be handled.

Top 25 Microfinance Institutions in India 2014

1. Annapurna Microfinance Pvt Ltd
2. Arohan Financial Services Pvt Ltd
3. Asirvad Microfinance Pvt Ltd

4. Bandhan Financial Services Pvt Ltd
5. BSS Microfinance Pvt Ltd
6. Cashpor Micro Credit
7. Disha Microfin Pvt Ltd
8. Equitas Microfinance Pvt Ltd
9. ESAF Microfinance and Investments Pvt Ltd
10. Fusion Microfinance Pvt Ltd
11. Grama Vidiyal Micro Finance Ltd
12. Grameen Financial Services Pvt Ltd
13. Janalakshmi Financial Services Pvt Ltd
14. Madura Micro Finance Ltd
15. RGVN (North East) Microfinance Limited
16. Satin Creditcare Network Ltd
17. Shree Kshetra Dharmasthala Rural Development Project
18. SKS Microfinance Ltd
19. S.M.I.L.E Microfinance Ltd
20. Sonata Finance Pvt Ltd
21. Suryoday Micro Finance Pvt Ltd
22. SV Creditline Pvt Ltd
23. Swadhaar FinServe Pvt Ltd
24. Ujjivan Financial Services Pvt Ltd
25. Utkarsh Micro Finance Pvt Ltd

Other Emerging New MFI's in India

"The importance of synergy between Government, Private sector and NGOs to address issues related to microfinance is well recognized by the members and they suggested for incorporating a brief about government initiatives for micro financing under various poverty alleviation and livelihood promotion programmes"[3]

1. Adhikar Microfinance Pvt Ltd
2. ASA International India Pvt Ltd
3. Belstar Investment & Finance Pvt Ltd
4. Chaitanya India Fin Credit Pvt Ltd
5. Future Financial Services Ltd
6. Growing Opportunity Finance (India) Pvt Ltd
7. Humana People to People India
8. IDF Financial Services Pvt Ltd
9. Indian Cooperative Network for Women Ltd
10. M Power Micro Finance Pvt Ltd
11. Mahasemam Trust
12. Margdarshak Financial Services Ltd
13. Pahal Financial Services Pvt Ltd
14. Rashtriya Seva Samithi
15. Sahara Utsarga Welfare Society
16. Sahayog Microfinance Ltd
17. Saija Finance Pvt Ltd
18. Samhita Community Development Services
19. Sanghamitra Rural Financial Services

20. Sarala Women Welfare Society
21. Shikhar Microfinance Pvt Ltd
22. Uttrayan Financial Services Pvt Ltd
23. Vedika Credit Capital Ltd
24. Village Financial Services Pvt Ltd
25. YVU Financial Services Pvt Ltd

Benefits of Microfinance

Microfinance opened many gates for lower income group in India. Micro financing produces many benefits for poor, or low- income households. One of the benefits is that it is very accessible. Banks don't provide loans to those with little to no assets, and generally don't give small size loans. Through micro financing small loans are produced and accessible. Opportunity to approach: Microfinance provides loans to those who have little assets. It acts as the staircase that gives access to the poor to end their poverty. "Microfinance providers who are engaged in helping the poor have overcome this barrier of collateral by adopting a unique mechanism of group lending. Therefore microfinance lending is commonly referred to as group based lending.[4]

1. **Most of microfinance loans are provided to women. Women borrowers are found to be more reliable when it comes to repayment of loans.**
2. **Microfinance gives small loans to people who want to make their children study.**
3. **It helps lower income group to make better living of standard.**
4. **Microfinance helps poor people to sustain at the time of financial problems.**
5. **Microfinance creates job opportunities to people without much economic support.**

Flaws of Microfinance

Every coin has two faces and when it comes to country like India, policy making and implementation is not always same. There are many challenges within microfinance initiatives which may be social, financial, administrative and political. Here, some community members may cheat poorer or less-educated borrowers. The reasons could be accidental or through deliberate attempt and even loosely run organizations. Microfinance initiatives require a large amount of social capital or trust in order to work effectively. The ability of poorer people to save may also according to inflation and rise in prices of commodities. Rates of providing loan and charging interest doesn't consider the inflation. "Lopsidedness in the distribution of microfinance facilities has continued through the years. The south has dominating presence in the sector. While states such as Karnataka seem to have saturated their districts with microfinance, there are other states like Bihar, Chattisgarh and Jharkhand that have yet to have MFIs reaching their hinterlands."[5]

1. Microfinance is of not much use to people who want to start big business.
2. Men are not much attracted to borrow from Microfinance Institutions because they don't provide large amount of loans.
3. Interest rates in Microfinance Institutions are very high.
4. There is no proper collection procedure, if someone refuses to repay the loan.

Microfinance Institutions (Development and Regulation) Bill 2012

Why Bill was made?

The Bill was needed to strengthen the regulatory framework and consumer protection norms of the microfinance industry in India. An ordinance was made after a series of suicide incidents as a result of abusive practices of MFIs such as charging high interest rates, adopting coercive collection practices and lending aggressively beyond the repayment capacity of the borrowers rather than helping the poor get out of poverty. According to one report “more than 77 rural people have been driven to suicides unable to bear the coercion unleashed by their recovery agents”[6]

Due to Andhra Pradesh crisis a law was passed to regulate Microfinance in India. It is necessary to stop large bad debts due to restrictions on collection practices. This restriction also stresses Microfinance Institutions to lend loans to poor. “This new Bill both seeks to protect consumers and recognizes the need to maintain access, stating clearly that its purpose is facilitating access to credit, thrift and other microfinance services to the rural and urban poor and certain disadvantaged sections of the people and promoting financial inclusion. The Bill has to be passed by both houses of Parliament before it becomes law”.[7]

Specifics of Bill

1. The Bill seeks to provide a statutory framework to regulate and develop the micro finance industry.
2. The Reserve Bank of India (RBI) shall regulate the micro finance sector; it may set an upper limit on the lending rate and margins of Micro Finance Institutions (MFIs).
3. MFIs are defined as organisations providing micro credit facilities up to Rs 5 lakh, thrift collection services, pension or insurance services, or remittance services.
4. The Bill provides for the creation of councils and committees at central, state and district level to monitor the sector.
5. The Bill provides for a Micro Finance Development Fund managed by RBI; proceeds from this fund can be used for loans, refinance or investment to MFIs.
6. The Bill requires the RBI to create a grievance redressal mechanism.

But the MFIDRB (2012) does not appear to have the ability to distinguish MFIs that operate legally from those MFIs that:

a) Microfinance institutions lend more to the people than their repayment ability

b) MFIs are mismanaged

c) Methods of recovery should be specific

d) MFIs must not use forceful methods

e) MFIs should not engage in wrongful deception

f) Has many flaws in the system

Standing Committee rejected the Bill

A Parliamentary panel has rejected the bill on microfinance institutions (MFIs) and asked the government to bring a fresh legislation before Parliament. “The bill had sought to empower the Reserve Bank to regulate them and fix interest rates ceiling on loans to be provided by MFIs. The

Parliamentary Standing Committee on Finance headed by senior BJP leader and former finance Minister Yashwant Sinha, has observed in its report tabled in Lok Sabha, that it requires wider consultations and said, Bring forth a fresh legislation before Parliament. The panel has also suggested to constitution of a unified and independent regulator for the entire micro finance sector as a whole, which may be termed as the Micro Finance and Development Regulatory council (MFDRC) with representatives from all agencies and institutions concerned like RBI, NABARD and SIDBI and the nominees from central government and MFIs".[8] The bill was drafted after Andhra Pradesh crisis. Under this Act there will be compulsory registration of MFIs with the RBI. "The MFDC (Micro-Finance Development Council) currently proposed in the MFIDRB (2012) will have huge conflicts of interest (because lenders and DFIs are to be on its board as also the MFIs). The MFDC will also be ineffective because it would have lot of authority without any responsibility or accountability and also because there would be a dual power structure – the MFDC and the RBI, which is to be the regulator and supervisor as per the MFIDRB (2012)".[9]

The Bill has several problems which the Parliamentary Standing Committee highlighted. And Bill needs to have:

1. The MFIDRB (2012) will have to specify minimum (non-negotiable) standards for various systems at MFIs – ranging from governance, compensation, risk management, MIS, internal control, internal audits, etc and the like. All MFIs which desire to come under the bill will have to follow these standards and there must be appropriate mechanisms to ensure that these standards are being met on a regular basis. The MFIDRB (2012) needs to specify these standards upfront and right now as otherwise it will not happen.
2. The MFIDRB (2012) will also need to outline appropriate incentive and disincentive mechanisms so that the carrot and stick policy can be used to incentivize the MFIs towards client sensitive and sound operating procedures
3. And having seen the 2010 AP and other crisis situations in microfinance in India from very close quarters, I strongly believe that the following regulatory/supervisory arrangement would perhaps be most appropriate in the Indian context:

    - Prudential regulation/supervision for all types of MFIs should be under a specially created body (called Micro-Finance Regulatory and Development Authority, MFRDA – like IRDA, PFRDA etc), which can also confer on them the legitimacy to operate in the larger financial sector. Such regulation must ensure minimum standards on various parameters, including governance, risk management, compensation, internal controls, internal audits, MIS, and the like – as proposed above in MFIDRB (2012)
    - Capital market regulation/supervision of listed microfinance institutions (NBFC MFIs) should be under the oversight of the Securities and Exchange Board of India (SEBI).

4. Consumer protection and grievance redressal mechanisms are necessary to ensure that NBFC MFIs don't act as for profit money lenders. This must be led by the Micro-Finance Regulatory and Development Authority (MFRDA) - as proposed above - along with the respective state governments, which are locally present and have the wherewithal to supervise microfinance on the operations ground. Such involvement cannot be at the level of the district administration as cursorily proposed in the MFIDRB (2012). Rather it must be at the level of the state government and using a proper mechanism.
5. Only such a multipronged approach to regulation/supervision of MFIs would be most effective from an implementation perspective.

The Bill was loosely structured. It needs a proper regulatory framework. So, in the light of the above and also given the lack of a clear national microfinance policy guiding its overall strategy and implementation, the MFIDRB (2012) is indeed a hugely incomplete legislation.

The Bill which is under consideration of Standing Committee

"The sector is eagerly awaiting the passing of the Microfinance Development and Regulation Bill by the parliament which will establish legitimate space for MFIs to operate. The aim of the Bill is to regulate the sector in the customer' interest and also to avoid a multitude of microfinance legislations in different states. Compulsory registration of the MFIs would bring the erstwhile moneylenders into the fold of organized financial services in the hinterland who had been acting as MFIs so far"[10]

1. To provide legitimacy and a proper regulatory framework to MFIs and others involved in delivery of financial services to low-income people (Legitimacy for Microfinance Institutions and Players);
2. To ensure that MFIs indeed satisfy the broader objectives for which they have come into being (in the first place) and also that they operate and function in a sound and legal manner, in accordance with norms and standards required of such (pro-poor financial) institutions. This would also involve ensuring that MFIs (and especially the NBFC MFIs) don't operate like moneylenders (Regulation and Supervision of Microfinance Institutions and Players);
3. To protect clients from MFI bad practices like coercive repayment, abusive interest rates, fraudulent products and the like (Protection of Microfinance Clients);
4. To protect MFIs that operates legally and correctly from usury laws (Protection of Micro-Finance Institutions);
5. To prevent micro-finance crisis situations like what happened in AP (Andhra Pradesh) in 2010 (Prevention of Micro-Finance Crisis Situations).

Conclusion

India has many laws but the implementation is rather poor in most cases. Same is the case with Microfinance Bill. The Bill should have the proper mechanisms to ensure development of microfinance sector and prevent situations like the 2010 AP crisis. It can be said that repayment depends on factors within the control of the lending institution such as dependability and quality of loan service, proper communication channels, administrative efficiency, and personal relationship with the clients. There are several flaws as far as loan default management is concerned. Policy makers must make strategies to help MFIs and borrowers as well. Repayment is less because of the loopholes in the lending procedures. Hopefully Standing Committee on Finance (PSCF) pays sufficient attention to these critical issues. The objective is to benefit large numbers of low-income people, who continue to lack access to quality financial services at the grassroots.

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