ISSN- 0976- 495X 1 www.anvpublication.org

REVIEW ARTICLE

Microfinance: Challenges and Hope in Future

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ABSTRACT:
To provide financial access to very poor people and to meet the need for small amount of loans without collateral security, the concept of Microfinance started first in Bangladesh in 1972.Later on it developed in India in the form of Self Help groups in which members themselves were responsible for borrowing and repayment of loans out of common pooled savings. The first breakthrough emerged from policy support to enable informal self help groups of 15-20 members (mainly women) to transact with commercial banks. At a time when many questioned the need for specialized microfinance institutions (MFIs) in India, the Small Industries Development Bank of India recognized the opportunity and started implementation of an ambitious national programme. Providing loan and capacity building support to MFIs, this programme supported 70 MFIs and has disbursed US$46 million. The 2005 national budget has further strengthened this policy perspective and the Finance Minister Mr. P. Chidambaram announced "Government intends to promote MFIs in a big way". Many Micro Finance Institutions like SA-DHAN, CARE CASHE, SKS microfinance started in India for the welfare of needy people. Microfinance with an aim of providing financial support to needy people proved to be a "Macro–fiasco" in India specially in Andhra Pradesh. The MFIs themselves have overplayed their hand. Compared to neighboring Bangladesh, microfinance as a social business is quite new in India and less deeply rooted in traditional anti-poverty work than it is in the promotion of microfinance to profit-seeking investors (culminating in the IPO by SKS, the mega-MFI). The new MFIs have created the appearance of being far more concerned about doing well financially than in doing good for clients, community and nation. On one hand, the Indian crisis could encourage other governments with socialist leanings (like Bolivia and Ecuador) to lean harder on MFIs. The sensationalism or partial ignorance of the global and local press could paint all microfinance with the same negative brush and call into question the whole value of microfinance, maybe even make microfinance out to be a "bad guy" for the poor. This paper presents an overview of the how microfinance institutions started in India and what are various ways ahead in which Micro Finance Institutions can perform in better way.

KEYWORDS: Micro Finance, financial access, Self help Groups, Profit seekers

INTRODUCTION:
As the economy develops it moves from specializing in agriculture to manufacturing and then to services. With the Indian economy reaching the growth trajectory of 8-9% and targeting a sustained double digit growth in next decade the Govt. has set the objective of achieving financial inclusion as the top priority. Currently just about 45% of the population has access to bank accounts and there is just one bank branch for every 1600 people.

Received on 21.02.2011 Accepted on 20.04.2011

Asian J. Management 2(2): April-June, 2011 page 81-84

The low reach of banks discloses the fact that nearly 30 million people are being added to India's middle income group each year and the growing influence in tier II, III towns and rural areas reflect the growth potential of microfinance industry. Microfinance loans provide financial access to the poorest without demand for collateral security that allows many of them to start new businesses, grow existing businesses, insure against shocks due to bad weather and illness, and smooth consumption. In the absence of microfinance, the poor will have no choice but to approach the unregulated local moneylenders who provide services that are fast and flexible, but charge usurious interest rates in the range of 60-120 per cent per year — and who may often enforce repayment by illegal and exploitative means. The country's microfinance sector is growing rapidly, has outstanding loan portfolio of Rs 18,000-19,000 crore. Even the Reserve Bank of India (RBI) has appreciated the micro lenders' ability to reach out to the poor with doorstep facilities. Yet, it has time and again drawn criticism for its corporate governance practices.

This article looks at the growth in microfinance, keeping the current developments in perspective. But before looking at the current episode, it is important to have a perspective on how the microfinance space is organized and who the different of players in the market are. At this point of time there are three significant interventions in the provision of universal access to financial services.[1] The people's movement which has existed outside of the government schemes, banks and other interventions by entrepreneurs. This is led by non-governmental organizations (NGOs) that have remained true to the community-based model handout their financial mismatches without the intervention of the external world, and if there is an intervention it is a conscious choice collectively exercised by the people.[2] The intervention by the government pre-existed the people's movement and was expressed in the form of the self-help groups (SHGs). This has usually been supply-driven, addressing the institutional and physical infrastructure needs and offering standardized supply-side solutions or "schemes"[3] The market forces, which look at the poor as a market, have found a mechanism to deliver credit through an efficient delivery model. This approach is more than a decade old and has made rapid growth.

With a large portion of the world's poor, India is likely to have a large potential demand for microfinance. For this reason, it makes sense to consider the changing face of microfinance in India, in order to shed light on comparable changes in the field all over the world. We take up the third type of model in which MFIs are the product of market forces. The main forms of legal status or organizational forms used by microfinance institutions in India are non-governmental organizations (NGOs), Non-Bank Financial Companies (NBFCs), Local Area Banks (LABs), Cooperative Societies under the cooperative society act, and Public Societies/Trusts. Initially the NGO led MFIs started a market based model of inclusive finance. The idea was not only to provide micro credit to poor people but also to earn profit as well. Soon a good number of players entered the market. However the MFIs concentrated their operation in state of Andhra Pardesh.. Some of the private MFIs operating were SHARE, BASIX, and SKS etc. According to the World Bank, the major challenges to the successful provision of microfinance in India can be summarized as improving governance, professionalizing management, improving internal transparency, lowering costs, better targeting of the poor, expanding beyond credit to meet the diverse needs of borrowers, and a better financial infrastructure in order to scale up. in than initial stages these MFIs acted as NGOs but later on transformed themselves from NGO to NBFC (Non banking finance company). One of the main constraints of NGO-MFIs is the ability to mobilize deposits in order to diversify their funding sources and grow. This constraint stems from the RBI Act which states that no unincorporated bodies are allowed to accept deposits from the public. Therefore, the right to collect deposits from the general public is restricted to regulated institutions, and only cooperatives and NBFCs are subject to prudential regulations. The hopes that the demonstration of one Market-based experiment will attract more players have come true. Many more organizations have entered the market and are competing to lend to the poor. The process they have put the "understanding" of the needs of the poor aside and have started chasing targets and Quest for Numbers. For these institutions, the poorer are not seen as human beings having an individual identity, characteristic and need. Instead they are seen as data points that add up to their profit statements. Microfinance in the country went through aphasia of intense competition, leading to over-indebtedness and even the collapse of a few institutions. Commercialization of Microfinance led to the conflict between the interest of investor and the interest of borrowers. The multiple lending by the various MFIs and the ZERO tolerance for DEFAULT cases worsened the situation. With the client getting multiple choices and the anxiety of the client to get as much of finance as possible from multiple institutions and this coupled with the suppliers of credit meant. The client herself was trying to grow at an unnatural pace, or that the client had that that the client had begun to resort to adverse usage of credit. The microfinance sector has come under stress after numerous suicides by borrowers in Andhra Pradesh, coercive recovery practices, high interest rates and massive over lending leading to burst of Microfinance bubble with Krishna Crisis in 2005-06. The Andhra Pradesh government, caught in a very difficult situation, claimed to have no choice but to try and reign in the MFIs; It speedily enacted a hastily put together ordinance, which was not necessarily the most well drafted from a legal perspective but one that sufficient to stem the rot. Post ordinance, the repayments came down considerably and MFIs have also claimed that they are facing a resource (liquidity) crunch. The ordinance has subsequently become a bill.

At the ground level, the stress was showing. Clients for whatever reasons were committing suicides. At the institutional level, it appeared that the boardroom battles were all about stock options, cashing in, cashing out and boards should have been discussing whether their business model was showing cracks. Meanwhile the Reserve Bank of India has appointed a Board Sub-Committee in October 2010 to look into the Andhra Pradesh (and Indian) micro-finance crisis while the ministry of finance is said to be readying a special package for MFIs.The outstanding loans of MFI industry in AP as on November 2010 stood at Rs. 7527 crore. The aggregate loans outstanding per person in AP are around Rs 22000 and 11% of the households have borrowed from MFIs while around 83% of loans are from unorganized sector.

Many challenges were put forth against the microfinance sector:

- MFIs have attracted investors and investment capital as never before. Private equity and specialized microfinance investors invested in 17 deals in FY 2009, valued at INR 867 Crores. In the first half of 2010, 14 deals have already raised over US$ 300m. Much of the private capital is backed by aggressive growth plans laid out by the promoters of MFIs with a clear focus on financial bottom lines. The microfinance industry must question whether it believes in value creation or just valuation.
- A short-sighted view at this juncture will only ensure that these crises cannot be washed away. MFIs sell or assign most of their loan portfolio during the last quarter of their financial year, primarily to maintain their capital adequacy or debt to equity ratio at required levels.
- It is also worth reiterating that one major constraint for MFIs in India is that they cannot (as banks can, and as MFIs can in some other countries) accept deposits, or borrow money from the central bank. In addition they do not, for the most part, collect collateral. These factors raise the MFIs'cost of funds significantly.
- MFIs also argue that the cost of credit from banks is high and that they should be allowed to mobilize public deposits if interest rates are capped.

Addressing all the above challenges will require investment in human resources and systems through capacity development encompassing both training and technical assistance. Worldwide (and in India too) training and capacity development remains the single biggest challenge for microfinance. MFI leaders report that there's no regular supply of trained manpower either at the grass root level or at the management level. As a result MFIs are forced to rely on *ad hoc* in-house training methods and infrastructure, which does not yield the professionalism and competencies that they need to build strong and effective financial institutions.

The report of the Malegam Committee set up by the RBI to look into the problems of microfinance institutions (MFIs) disappoints. One recommendation seeks to make at least the bigger MFIs more robustly regulated, by converting them into a special category of NBFC.

Where it falls short is that it fails to draw a line between the ideal and the feasible. Many of its recommendations, such as the cap on interest rates (24%) or on the interest margin, will be near-impossible to enforce. Such caps have not worked in the past and are unlikely to work in the future.Likewise, it is going to be near-impossible to ensure compliance with the multitude of conditions required to qualify as an NBFC-MFI - it must provide financial services predominantly (90%) to low-income borrowers (specified as those with annual family income of less than 50,000), Or to prevent those that do not qualify as NBFC-MFI from lending more than 10% of their total assets to the microfinance sector. It is well-known that MF loans are largely of the nature of bridging loans that help the poor tide over a consumption-related funds crunch. Hence, insistence on loans being made 'primarily' for income-generating may once again detract from their allure.

The committee is aware of these dangers. It points out that a balance has to be struck between the benefits of restricting loans only for income-generating purposes and recognition of the needs of low-income groups for loans for other purposes. But its recommendations do not seem to have taken into account the ground realities.

To the extent MFIs service 26.7 million customers with outstanding loans of 18,344 crore, of which about 75% is bank-financed, there is a need to keep an eye on them. But with an eye also on the cost-benefit trade-off and a danger of spreading regulatory resources too thin. In any case, the real threat to microfinance is from politicians who instigate loan default promising an inevitable waiver.

Confusion continues to reign in the debate on microfinance that has unfolded following the promulgation of the Andhra ordinance, soon to be replaced by Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Act, 2010.

A key confusion has been that microfinance is a major instrument of poverty alleviation. Going by the available scientific evidence and agreement among scholars, to-date, there exists no compelling study linking the expansion of microfinance to declining levels of poverty. Despite the images of groups of women starting small business projects to exit poverty, commonly promoted on the websites of microfinance institutions (MFIs), the use of microfinance for such projects has been surprisingly tiny The link between combating poverty and microfinance is even weaker when we consider for-profit MFIs. The operations of these institutions are disproportionately concentrated in the better-off southern states rather than poverty-stricken states in the north and east. And even in the southern states, they have not been the pioneers: the microfinance movement was already flourishing there by the time they arrived on the scene.

Critics of the Andhra ordinance have often avoided distinguishing between for-profit and non-profit MFIs. This has given the misleading impression that all MFIs are benign entities engaged in helping the poor alongside the self-help groups (SHGs) that the Andhra government has promoted and has partially sought to protect through the ordinance. But the two sets of entities are quite different.

Non-profit MFIs have been an integral part of Indian microfinance landscape almost from the beginning and have operated harmoniously side-by-side with the SHGs in states such as Andhra Pradesh. The complaints of usurious interest rates and coercive loan recovery practices, traditionally leveled against the village moneylender, surfaced against MFIs only after they began to convert into for-profit entities. A mini-crisis involving such complaints had first erupted in March 2006 in Krishna district of Andhra Pradesh. Unfortunately, no long-term lessons were learned from that episode.

Future of Microfinance:
It will be an understatement to state that the business of microfinance, as it has existed till now, is under serious threat

While MFIs face a host of challenges, their socio-economic mission endows them with special advantages. "We should expect MFIs to succeed where they continue to operate in underserved markets. Analysts should therefore examine whether an MFI's mission and programs focus on traditional microfinance or not," According to Blue Orchard in Microfinance Focus.

This includes an evaluation of the MFIs position in the market and its ability to survive unanticipated events. We also review the economic condition of countries in which the MFIs are located.

Another lesson learned from this crisis is to scrutinize not only the procedures and policies of an MFI, but also the implementation of these practices. With the growth we've seen in the industry over the past few year, credit policies were relaxed in favor of higher growth rates. Many loan officers were incentivized based on the growth of their portfolio alone. Instead of focusing only on growth, the importance of portfolio quality and knowing their clients should also be stressed in loan officer training sessions and reflected in compensation packages. If loan officers are incentivized in the right way, they will put more energy into choosing the right clients for the MFI

An important aspect to consider is the over-indebtedness level of clients. If clients have borrowed beyond capacity, it is easy to see why they might throw their support behind a group that is telling them they do not have to make payments on this debt. If there is a centralized credit bureau that both regulated and non-regulated microfinance entities report to, this over-indebtedness can be avoided. MFIs can implement new credit procedures that can accurately assess the repayment capacity of their clients

Finally, the MFI's key strength – its management – will surely not be found in a spreadsheet. Managing a MFI requires leaders with a rare combination of skills. Amongst other things, they must have a thorough understanding of their immediate environment while keeping sight of the wider financial context, and they must be quick to adapt to any changes. They have to train staff to the peculiar business of microfinance and reaching out to clients who may have only the most limited understanding of managing their finances.

CONCLUSION:

We conclude that there is a need for a common platform in India for MFIs to measure both the categories of poverty they are targeting as well as whether or not they are having a sustained impact on the income and living standards of their clients. With such information in our hands, we would be in a much better position to say meaningful things about what Microfinance has done and might be able to do for the poor in India.

The changing face of microfinance in India appears to be positive in terms of the ability of microfinance to attract more funds and therefore increase outreach, But the need of the hour is to strike a balance between the social and commercial goals that means these institutions must be act as being responsible in credit delivery and do not lend more than what borrowers desire or more than their repaying capability.

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