Conventional Micro Financing- Challenges and Opportunities

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Introduction of Microfinance

Oxford learner's dictionary defines Microfinance *as* "A system of providing services such as lending money and saving for people who are too poor to use banks". According to ***Investopedia.com*** "Microfinance, also called microcredit, is a type of banking service that is provided to unemployed or low-income individuals or groups who otherwise would have no other access to financial services." The borrowing limit, excluding educational or medical expenses, has been doubled to Rs. 1 lakh from the existing Rs. 50,000, the RBI notified in its first bi-monthly monetary policy statement in the new fiscal year that began on April 1, 2015. The increase in the limit was suggested by the Nachiket Mor committee on Comprehensive Financial Services for Small Businesses and Low Income Households. The new cap proposed by Microfinance Institutions Network (MFIN) is set at Rs 80000, up from Rs 60000 under the joint liability group model.1

Why Microfinance?

Milton Friedman once said that "the poor stay poor, not because they're lazy, but because they have no access to capital." Till date, a huge section of population remains outside the formal banking system. Microfinance institutions are the only ones equipped to reach the 'unbankable' or 'unbanked' masses, and make financial services accessible to them.2

History of Microfinance

The microfinance movement was started off by one man: Dr Muhammad Yunus, with one vision: to eradicate poverty from the world. Muhammad Yunus, the Bangladeshi economist, widely known as the Father of Microfinance founded the Grameen Bank to make small loans to the poor in Bangladesh. The success of the Grameen microfinance model has inspired hundreds of countries throughout the world, including the USA. Grameen Bank and Dr Yunus jointly won the Nobel Peace Prize in 2006.3. The evolution of microfinance in India can be traced to cooperative movement started in 1900 credit cooperatives were extending subsidized credit to villages under government sponsorship. Subsequently With failure of cooperatives, the government focused on measures such as nationalization of Banks, establishment of Regional Rural Banks (RRBs) and the setting up of apex institutions such as NABARD & SIDBI during 1960-1990. The failure of subsidized social banking triggered a paradigm shift in delivery of rural credit with NABARD initiating the Self Help Group (SHG) Bank Linkage Programme (SBLP) in early 1990s.4

Microfinance delivery Model

There are mainly two models for delivery of Microfinance in India:5

1) SHG – Bank Linkage Programme (SBLP)
2) Micro Finance Institutions (MFIs)

1) SHG – Bank Linkage Programme (SBLP)

A SHG is a small group of about 10-20 persons from a homogeneous class of rural and urban poor which promoted savings among members and used these resources for meeting their credit needs.

2) Micro Finance Institutions (MFIs)

MFI model is found worldwide whereas the SHG-BLM model is an Indian model. In MFI model MFIs borrow large amount of funds from the apex financial institutions, donors and banks for on-lending to the individuals or groups. These MFIs provide financial services to the individuals or to the groups like SHGs.

Growth and Outreach

According to Sa-Dhan's (The Association of Community Development and Microfinance Institutions) "Bharat Microfinance Report – 2017" MFIs currently operate in 29 States, 4 Union Territories and 563 districts in India. The reported 168 MFIs with a branch network of 10,233 and 89,785 employees have reached out to 29 million clients with an outstanding loan portfolio of `46,842 crore.

Performance of MFI and SHG Model

Indicators: MFI Model	2017	2016
Client Outreach	295 lakh	399 lakh
Women Clients	96%	97%
SC/ST Clients	20%	30%
Other Minorities	10%	27%
Rural Clients	61%	38%
Gross Outstanding Portfolio	46,842 Cr.	63,853 Cr.
NPA	0.69%	0.15%

The Bharat Microfinance Report 2017

Performance of SHG Model

Indicators: SHG Model	2017	2016
Total No of SHGs Linked	85.77 lakh	79.03 lakh
No. of Families Reached	112 million	103 million
Total Savings of SHGs	16,114 Cr	13,691 Cr
Total No. of SHGs Credit Linkage	18.98 lakh	18.32 lakh
Gross Loan Outstanding	61,581 Cr	57,119 Cr
Total Loan Disbursed	38,781 Cr	37,286 Cr
Avg. Loan Disbursed per SHG	2,04,314	2,03,495
NPA	6.50%	6.45%

The Bharat Microfinance Report 2017

Challenges of Microfinance Institutions

This sector deals with the poorer section of the society. Major challenges of microfinance institutions are identified as-6

High rates of interest as compared to mainstream banks

MFIs' when compared to commercial banks do not enjoy the same rate of financial success. One of the reason is that while banking system is centuries old, micro finance is only a few decades old in India (Pathneja, Narwal and Kumar, 2015). MFIs' charge a very high rate of interest (12-30%) as compared to commercial banks (8-12%). Recently, the RBI (India's regulatory bank) announced the removal of upper limit of 26% interest on MFI loans (ET, 2014). This has benefited the industry's players but left the customers in a worse situation than before. Due to the issues of over-indebtedness caused by the charging of high interest rate, rate of suicide of farmers increased in states like Andhra Pradesh and Maharashtra

Over-dependence on the banking system

Majority of the MFIs' in India are registered as Non-Governmental Organizations (NGOs). They are dependent on financial institutions such as commercial banks for stabilised funding for their own lending activities. Around 80% of their funds come from banks. Most of these are private banks which charge a high rate of interest and also the term of loans is of shorter period.

Illiteracy and lack of awareness about the products

Illiteracy and lack of knowledge about the financial products offered by the microfinance institutions is one of the challenges of microfinance institutions. Like all other developing and underdeveloped countries, the literacy rate in India is very low and the rate is much lower in the rural areas. Nearly 76% of India's adult population does not understand basic financial concepts (Sud, 2017). Lack of awareness of financial services provided by the Indian microfinance industry is a challenge for both, customer and MFIs'. This factor not only causes hindrance for villagers to join hands with MFIs' to meet their financial needs but also makes them financially excluded. MFIs' are faced with the task of educating the people and establish trust before selling their product. Micro finance institutions struggle to make their business more financially viable due to this lack of awareness (Ancona 2014).

Over-indebtedness due to multiple borrowings and inefficient risk management

Microfinance institutions (MFI) provide financial services to the poorer section of the society in order to improve their standard of living. Therefore over-indebtedness is major issue. Lack of risk management framework and multiple borrowings by most clients led to micro-finance crisis in India in 2008. In some cases, it has been seen that there is no apex control over the MFIs'. This sector gives loans without collateral which increases the risk of bad debts. Moreover the fast paced growth of the sector has not been met with proper infrastructure planning.

Problem in identification of appropriate model

In India, most of the MFIs' follow Self-Help Group model (SHG model) or Joint Liability Group model (JLG model). The problem is that most of the time, selection of model are not scientific in nature. The models are selected randomly, not according to the situation and also the decision of selection is irreversible in nature. So, it affects the sustainability of the organisation in the long-run and also increases the risk of borrowings for the poorer section beyond they can bear. This is also one of the main reasons of crisis of microlending in the state of Andhra Pradesh.

Opportunities for MFI in India

Out of 29 million SMEs, only 1 mn are financed by banks. Remaining 27 mn have no registration certificate. It is a sector with huge unfulfilled demand.7 MFI currently works in 28 states and 561 districts. Nearly 50% of total MFIs in India are concentrated in only one state, 30% in 2 to 5 states. Rest of India has very few shares of MFIs and small loan financing facilities. As of 2013-14, 11687 MFI branches have been there across India with more than 1200 branches in Andhra Pradesh alone. As of March 2016, the total savings across all SHGs have reached 13691 crores. Nagaland, Tripura, Jharkhand, Maharashtra and Assam have seen all time high in the branches of MFIs. (S. Saravanan, Devi Prasad Dash 2017).8

Conclusion

So there is huge scope and opportunity for MFI to grow across India rather than concentrating in few states. Keeping in view the challenges of high interest rate (higher than the traditional banks) charged by conventional microfinance, there is huge scope to grow interest free microfinance for rural and semi urban poor.

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