Contribution of Micro-finance Institutions for the Development of Rural Community Region- Its Critical Aspects of the Success

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ABSTRACT

Microfinance emerged as a noble substitute for informal credit and an effective and powerful instrument for poverty reduction among people, who are economically active, butfinancially constrained and vulnerable in various countries. Microfinance covers a broad range of financial services including loans, deposits and payment services and insurance to the poor and low-income households and their micro enterprises. Microfinance institutions have shown a significant contribution towards the poor in rural, semi urban or urban areas for enabling them to raise their income level and living standards in various countries.In developing countries like India the structure of economy is dualistic. The rich getricher and the poor get poorer. This worsens the access of poor to economic opportunities andreaches for formal financial services. Rural people in India suffer from a great deal ofindebtedness and are subject to exploitation in the credit market through high interest rates and lack of convenient access to credit. They need credit to fund their working capital needs on aday-to-day basis as well as long term needs like emergencies or other income related activities.So the need for financial assistance is essential to alleviate poverty for consistent economic growth. Despite the numerous achievements made by the microfinance service providers, employees and recipients of the services, there has been some setbacks which made the sector unstable, least trusted and unattractive in the early 1990s such as the frequent scam where depositors moneys were taken away, ineffective monitoring of the operators by the central bank; this situation lead to many mushroom microfinance companies springing up and dying out at tender stages therefore collapsing smaller businesses. In recent years, the criticism has also been centered on the very high interest rates charged by most microfinance services providers. This has caused the collapse of some small scale business therefore not serving the purpose for which it was intended to achieve i.e. poverty alleviation. Borrowers then become over burden with payment of loan or interest.

This paper examines the actual attainment of success that microfinance institutions and non-profit organizations attempts for the growth and development of the society specifically the rural region. The financial Inclusion were providing by these organizations for accelerating the growth and development of rural region but we through this paper are trying to examine whether the services availed by rural people are really utilizing for their self growth and attainment and whether the Micro Finance Institutions (MFIs) are contributing for the growth of people residing in rural area. We are also trying to find out whether there are any other reasons that why people are not approaching these services or are there any hurdle in getting the facilitation of those services. It has been observed through literature review that financial inclusion provided by Government through these MFIs are not been reached to rural areas. The reason being the unhealthy practices been adopted at both receiver and the sender end.

Keywords

Micro-finance Institutions, Rural Community, Self-Help Groups, Financial Inclusion, Growth and Development

1. INTRODUCTION

1.1 Microfinance

Microfinance" as a branch of economic development for those who lack access to resources has garnered considerable recognition over the last several years, much of it due to the 2006 awarding of the Nobel Peace Prize to Dr. Mohammed Yunus, a US-trained, Bangladeshi economist who serves as the global figurehead for the microfinance movement.

Microfinance is commonly understood to refer to the provision of credit services to those who have traditionally been considered too poor and uneducated to qualify for access to loans. When the first microfinance models were being developed in the 1970s and 1980s, the term "microcredit" was used interchangeably with "microfinance". Today, however, microfinance can refer to the provision of numerous types of financial services, the majority of which are made on what those living in the developed world would consider to be an extremely small scale. These can include loans, savings accounts, insurance and pension products.

Large scale attempts, usually by governments, to widen access to the financial system for those living in economically underdeveloped areas is not new. Also till 2011, a vast number of individuals and their families continue to be underserved or outright excluded from this system by government and retail bankers. This is primarily due to potential users having a high risk profile and lacking a basic financial education. The novel contribution of microfinance is that it tailors its lending models to fit the socioeconomic circumstances of the poor and involves a greater emphasis on supplementary social and education services for those who are new to using the types of retail financial tools (personal loans, savings accounts, etc.) that those of us in the developed world take for granted. Most of us living in the West could not imagine life without a bank account or pension plan but the majority of the worlds extremely poor have no concept of how such services work. Microfinance makes these tools for building financial security available to the poor for the first time.

1.2 Salient features of Microfinance

- Borrowers are from the low income group
- Loans are of small amount – micro loans
- Short duration loans
- Loans are offered without collaterals

- High frequency of repayment
- Loans are generally taken for income generation purpose

1.3 Gaps in Financial system and Need for Microfinance

According to the latest research done by the World Bank, India is home to almost one third of the world's poor (surviving on an equivalent of one dollar a day). Though many central government and state government poverty alleviation programs are currently active in India, microfinance plays a major contributor to financial inclusion. In the past few decades it has helped out remarkably in eradicating poverty. Reports show that people who have taken microfinance have been able to increase their income and hence the standard of living.

About half of the Indian population still doesn't have a savings bank account and they are deprived of all banking services. Poor also need financial services to fulfill their needs like consumption, building of assets and protection against risk. Microfinance institutions serve as a supplement to banks and in some sense a better one too. These institutions not only offer micro credit but they also provide other financial services like savings, insurance, remittance and non-financial services like individual counseling, training and support to start own business and the most importantly in a convenient way. The borrower receives all these services at his/her door step and in most cases with a repayment schedule of borrower's convenience.

But all this comes at a cost and the interest rates charged by these institutions are higher than commercial banks and vary widely from 10 to 30 percent. Some claim that the interest rates charged by some of these institutions are very high while others feel that considering the cost of capital and the cost incurred in giving the service, the high interest rates are justified.

1.4 The Call for Financial Inclusion

Financial inclusion means that each and every citizen of the country, who is poor, underprivileged and disadvantaged, must be delivered with the financial services available in the country. The problem of financial inclusion is less in urban areas as compared to those in rural and remote areas who have no or minimum access to the financial services. According to the World Bank's India Development Policy Report (2006), 60 per cent of India's poor do not have a bank account and 87 per cent do not have any access for credit from formal sources. Though improvement continues but stillhalf of adults around the world remain unbanked, at least 35 percent of them report barriers to account use that might be addressed by public policy. Among the most commonly reported barriers are high cost, physical distance, and lack of proper documentation, though there are significant differences across regions and individual characteristics (World Bank Report, 2011). It was also concluded by the study of a commercial bank that more than 51 per cent of the total cultivator households had no access to the formal sources of finance. The Khan Commission, set up in 2004 by the Reserve Bank of India in order to look into the financial inclusion, recommended for making available a basic „no frills" banking account, relaxing the KYC (Know Your Customer) norms, issuing General Credit Cards to the poor and allowing the commercial banks to use the services of the NGOs, SHGs, and MFIs as intermediaries to provide financial assistance to the poor and disadvantaged people. However, microfinance evolved in India, in the early 1980s with the formation of informal Self Help Group (SHG) for providing access to financial services to the needy people who are deprived of credit facilities. In 1999, SHG financing became a National priority sector.

The main players in the microfinance sector are the NABARD, SIDBI and the RMK who have helped in achieving the financial inclusion objective of the government to a large extent. National Bank for Agriculture and Rural Development, the regulator for microfinance sector, and Small Industries Development Bank of India are devoting their financial resources and time towards the development of Micro.

2. THE PLAYERS IN THE MICROFINANCE SECTOR

2.1. National Bank for Agriculture and Rural Development (NABARD)

The National Bank for Agriculture and Rural Development (NABARD) aims at facilitating sustained access to financial services for the unreached poor in rural areas through various microfinance innovations in a cost effective and sustainable manner. NABARD has planned to link nearly 9.2 crore households which would ensure coverage of more than 50% women through SHG Bank linkage programme by the end of 2015. The number of SHGs financed under the SHG-Bank Linkage Programme increased from 1.98 lakh in 2001-02 to 6.87 lakh in 2006-07. Various steps taken by the NABARD in this respect are Training and Capacity building of the SHGs, Micro Enterprise Development Programme (MEDP) for Skill Development, Grant Support to Partner Agencies for Promotion and Nurturing of SHGs, Pilot Project on SHG Post office Linkage Programme, Rating of Micro Finance Institutions (MFIs), Capital / Equity Support to Micro Finance Institutions (MFIs), and Revolving Fund Assistance (RFA) to MFIs.

2.2. Small Industries Development Bank of India (SIDBI)

The Small Industries Development Bank of India (SIDBI) started its microfinance scheme in January, 1999 with a capital of Rs 100 crore and a network of about 190capacity assessed rated MFIs/NGOs. The SIDBI has assisted in the microfinance sector by Lending to the MFIs/NGOs, Liquidity management support to the MFIs/NGOs, Providing equity capital to the MFIs/NGOs, Providing loan to MFIs/NGOs for the transformation of their structure, Micro enterprise loans to the MFIs/NGOs, and Micro Enterprises Loan Scheme-Direct Credit to micro enterprises.

2.3. Rashtriya Mahila Kosh (RMK)

The National Credit Fund for Women or the Rashtriya Mahila Kosh (RMK)was set up in March 1993 as an independent registered society by the Department of Women & Child Development in Government of India's Ministry of Human Resource Development with an initial capital of Rs. 310,000,000 to fill the gap between what the banking sector offers and what the poor need. The Rashtriya Mahila Kosh aims at providing micro credits to the poor women who have no access to the financial services available in the country. The RMK helps in micro finance by acting as a wholesaling apex organization for channelizing funds from government and donors to retailing intermediate microfinance organizations (IMOs), developing the supply side of the micro finance market by offering institution building support to new and existing-but-inexperienced IMOs by structures of incentives, transfers of technology, training of staff and other non-financial services, and, acting as an advocate or agent for influencing development and micro-finance policy and creating a more enabling policy and legal environment for spread of micro-finance activities in India.

2.4. Micro Finance Institutions (MFIs)

After the above mentioned three apex bodies in micro finance sector, Micro Finance Institutions (MFIs) are the most important pillars which assist these bodies in achieving their target of social development. MFIs were created to promote the key objectives of microfinance which is to help economically underserved communities achieve greater financial independence and build sustainable livelihoods. MFIN seeks to work closely with regulators and other key stakeholders to achieve larger financial inclusions goals through microfinance.

MFIs is a primary representative body and the Self-Regulatory Organization(SRO) for Non Banking Finance Companies (NBFC) Microfinance Institutions (MFIs) regulated by the Reserve Bank of India (RBI). MFIN currently has a membership of 42 NBFC-MFIs, which on an aggregate basis constitute over 89% of the microfinance business in India.

The core areas of work for MFIN are Self Regulation, Policy Advocacy and Development

2.5. SELF-HELP GROUPS (SHGs)

Self Help Groups are groups of about 10 to 20 people who come forward with an aim of eradicating poverty and social development through their own contribution. They provide low interest loans to the members after a large sum have been pooled. First of all a group is formed, then all the members contribute some capital and then they are engaged into economic activities. SHGs are sometimes also referred to as “Micro banks” which have funds either of their own or through some other contribution of associations, cooperatives, MFIs and banks. They are the direct link to the poor people and hence the micro finance sector evolves around them. They are either linked to the banks or to the MFIs.

3. LITERATURE REVIEW

In a research article, ‘Examining the roles and future of Microfinance’ published in “The Guardian” (2012), it has been stated that the concept of microfinance has gained widespread support among policymakers, and been lauded for its potential to transform lives. But it has also come under closer scrutiny in recent years, with some questions raised about the effectiveness of microloans in particular as a way of combating poverty.A Guardian roundtable discussion, held in association with Barclays, provided an opportunity to debate these issues, examining the role of microfinance as we move towards a post-2015 development agenda and addressing some fundamental questions about its purpose, the forms it should take, and how it can be scaled up.

According to the information provided by Info resources in their article ‘Accessing financial services in rural areas’ - Many obstacles still make it difficult for rural households and entrepreneurs to access financial services. Accordingly, both service users and financial institutions offering services in rural areas are confronted with a broad array of challenges like high transaction costs, high credit risks and higher rates of illiteracy.

Unfortunately, even if financial institutions offer their services at reasonable costs, interest rates for loans remain high in rural areas. There is generally little or no competition among financial institutions in rural areas, and, consequently, the pressure to reduce interest rates is low.

According to Mac Farquhar, Neil (2010-04-13) in a cited article, "Banks Making Big Profits from Tiny Loans", it has been observed that poor people are still buried under the hefty profits been made by these institutions in terms of seeking interests on the loan provided to them.

“We created microcredit to fight the loan sharks; we didn’t create microcredit to encourage new loan sharks,” Mr. Yunus recently said at a gathering of financial officials at the United Nations (2010). “Microcredit should be seen as an opportunity to help people get out of poverty in a business way, but not as an opportunity to make money out of poor people.”

According to research paper Swain, R.B. and Wallentin, F.Y.: Does Microfinance Empower Women: Evidence from Self Help Groups in India. Uppsala University, Dept. of Economics Working Paper 2007:24. It has been observed that the minimalist microfinance approach is not sufficient. Additional services like training, awareness raising workshops and other activities over and above microfinance programs that merely focus on financial services are also an important determinant of the degree of its impact on the empowerment process of women. Future research needs to identify which factors in SHG programs have a greater impact on women’s empowerment.

4. OBJECTIVES

The objective of the research paper is to study the causes and reasons of unhealthy practices in the microfinance institutional sector.

5. RESEARCH METHODOLOGY

Data source

The data collected for the study includes secondary data.

The various sources used to collect the data include research papers, articles, annual reports of the company and various other websites.

6. CRITICAL ISSUES RELATED TO MICRO FINANCE INSTITUTIONS

6.1 It has been observed in various states especially in Andhra Pradesh where the MFIs using unhealthy practice and charging higher rates of interests in the various microfinance schemes (Reference to Andhra Pradesh Microfinance Ordinance, 2010).

6.2 The observation was also drawn that the interest/ margin gaps do not have substantial implications for the leading MFIs, their main effect resulted into difficult to reach areas and to the poor people. The current scenario has shown crises in microfinance in terms of lack of commitment and creating a better environment about the rights of clients. Some of the clients become over indebted which even leads to various suicides committed by the farmers in that area.

6.3 Financial Illiteracy is one of the major hindrances in the growth of Microfinance sector. Most MFIs think that by signing the document members accept the conditions claim in the document where they even don’t know how to read and write. Is this the financial literacy to them?

6.4 The major source of funds for MFIs is the bank loans, which is the reason for high Debt to Equity ratio of most MFIs. The reason being that MFIs were unable to raise sufficient funds because MFIs are worked for-profit motive that is why they are restricted from taking public deposits.

6.5 Most MFIs lend on the basis of the past record of the group i.e. Self Help Group(SHG) or Joint Liability Group (JLG) and lending is also based on the individual’s repayment performance. The major problems arising out with the group lending concept are dropouts (when one or more members leave the group) and migration (when one or more members move to another group).

6.6 Another reason for dropout of Microfinance sector is the competition among the MFIs. Though competition is good for many sectors but in this case it is going against both the parties. In order to eat away each others’ market share, MFIs are ending up giving multiple loans to same borrowers which in some cases is leading to over-indebtedness (a situation where the borrower has taken loans more than her/his repaying capacity) of the borrower. MFIs are getting affected because borrowers are failing to make payments and hence their recovery rates are falling, while over-indebtedness is making the borrower go to depression and in some cases forcing them to commit suicide.

7. OBSERVATIONS OF THE STUDY

7.1 It has been observed that at the initial time though the free hand was given to MFIs to empower the rural people but it has been observed that initiative are not been taken by MFIs at the same pace.

7.2 MFIs are not following the guidelines, rules and regulations and procedures as lay down by the government. The MFIs are not able to check in a proper way the performance of their ground staff and their recovery practice.

7.3 It has been observed that MFIs are generally opening their new branches mostly at the places where MFIs are already in operation.

7.4 It has also been observed that MFIs are charging usurious interest rates and even few MFIs have been charging additional rates which has been creating confusion among borrowers because the segment of borrowers are mostly illiterate. Therefore their bargaining power is too low.

7.5 It has been noticed that MFIs are using old techniques which is increasing the operational cost of MFIs.

8. RECOMMENDATIONS AND SUGGESTIONS

After analyzing all the aspects of MFIs for the development of rural region, there are certain notable recommendations which should be taken due care for making the micro finance sector more impressive and effective.

8.1 Government should encourage MFIs and provide them better facilities in terms of technology, funds, awareness programmes, better tools and techniques for the smooth functioning of MFIs.

8.2 We would also like to suggest that there should be clear and easily understandable guidelines and regulations should be laid down by the government because a basic objective of MFIs is to provide well-facilitation to poor people.

8.3 Rural areas should be benefitted by the outreach of MFIs. So that most of the MFI branches should be open up in rural areas where it is most required.

8.4 There should be equal rate of interest applicable to all the areas where the MFIs are facilitating the poor people because as we know the main objective of MFIs is to give facilitation to Below Poverty Line (BPL) people and empower the women in rural area.

"When there is no categorization among the people who are living below poverty line then why there is discrimination in the rates of interest charged by different MFIs."

8.5 Another reason for which we would like to draw attention is the increased cost of MFIs due to obsolete technology. Though MFIs has to lend the money to the borrowers at the low rate of interest due to which the cost is increasing but the revenue has not been coming up to the mark. Hence the technology should be enhanced in such a way that it minimizes the operating costs so that even the small MFIs can generate surpluses at the end of financial year.

MFIs should adhere to the policies and should attain their objectives specifically for the purpose for which they have been established. Therefore, it is highly recommended to review functional procedure of MFIs because their main objective i.e. facilitating and empowering poor people is somehow been defeated in the current working scenario of such financial institution.

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