An Overview of Microfinance Institutions in India

The microfinance institutions in India are just a beginning to display signs of future potential. So, microfinance overview is most important for the sustainable and successive growth of the economy. An economy may be developed if it is fairly conscious about the need and concept of microfinance institutions. This chapter provides an overview of the MFIs in India. It covers need and concept of microfinance institutions and also discusses the historical background of MFIs; the delivery methodology, the legal and regulatory frameworks.

1.1 NEED OF MICROFINANCE INSTITUTIONS

India is an emerging economy and poverty is still one of the major problems of the country. According to the National Sample Survey Office (NSSO), the number of poor persons below the poverty line in India in the year 2011, is 269.3 million. In such a diversified economy, it is offenly observed that poor people are not able to access the credit. This is the main reason for the failure to overcome the poverty level. Meeting the gap between demand and supply of credit in the formal financial institutions frontier has been challenging (Von Pischke 1991) cited in (Vichore & Deshpande 2012). In fact, the gap has not arisen simply that formal financial institutions have the shortage of loanable fund for the poor. It arises because poor people are not aware about the banking policy. They do not have any collateral security till they avail the loan facility. Lending to the poor involves high transaction cost and risks associated with information asymmetries and moral hazards (Stigliz and Weiss 1981). So, nonavailability of finance creates a problem for the poor peoples and it affects the economy in long term. Many private lenders exploit the poor people and charge a high-interest rate. The poor people are not able to repayment the loan with the high-interest rates. This is one of the reasons that suicide cases are increasing. So, there is a need to make credit facilities to poor people at a lower rate of interest for the development of the economy. So, governments
of emerging economies take an action to reduce the gap between demand and supply of credit by microfinance institutions till they provide microcredit to the poor people.

1.2 CONCEPT OF MICROFINANCE INSTITUTIONS

Microfinance is the provision of a broad range of services such as saving, credit funds, insurance, etc. provided to low-income households and enterprises (Roy 2011). It is also the provision of financial services to low-income clients, including the self-employed (Coleman & Oesi 2008; Koveos & Randhawa 2004). Similarly, microfinance can be defined as the attempt to improve access to small deposit and small loans for poor households neglected by banks (Schreiner & Colombet 2001). So, microfinance institutions mainly provide a small loan to low income people with the objective of helping them to engage in productive activities (Hassan et al. 2012). Microfinance is not just about giving micro-credit to the poor rather it is an economic development tool whose objective is to assist poor to work their way out of poverty. It covers a wide range of services like credit, savings, insurance, remittance and also non-financial services like training, counseling etc (Arena 2011).

Salient features of Microfinance:

- Borrowers are from the low-income group
- Loans are of small amount – microloans
- Short duration loans
- Loans are offered without collaterals
- Repayment frequency is high
- Loans are generally taken for income generation purpose

From the above mentioned features, it is observed that microfinance offers financial services to the working poor those who were previously considered ‘unbankable’ because of their lack of collateral. Microfinance implies providing the poor in rural and urban areas, especially women, with saving and credit facilities to set up or expand the business, invest in self-employed activities and increase household security. Microfinance target group is low-income clients, particularly women because they have lower income and not able to access credit to other financial institutions. However, there is significant evidence of microfinance institutions mission devoting their funds to women since their interest to sustain themselves is confirmed by high repayment rates (D’Espallier et al. 2009). It is also examined that women particularly benefitting from microfinance. (Vyas 2012) Microfinance services led to women’s empowerment by positively influence women’s decision-making power and
enhanced their overall socio-economic status. It also provides a better-working condition for women. So, the scheme of microfinance as a dominant appliance for flourish the poor above the level of poverty by providing them self-employment opportunities and making them credit worthy (Shastri 2009). (Ananda & Colaco 2012) Microfinance is assuming a special concernment in the concern of increasing emphasis on poverty alleviation, women empowerment and rural development in India. (Hartarska & Nadolnyak 2008) Microfinance institutions have helped the poor to alleviate micro business funding constraint and uplift them onto a higher economic status. (Cull et al 2006) microfinance institutions help to mobilize considerable resources required for economic development.

However, microfinance benefits can only be realized as long as the poorest of the poor continue to be clients of microfinance institutions (Hiatt & Woodworth 2006). So, it observed that microfinance institutions focus on its client till they benefited from them and give the contribution to enhancing the economic development.

1.3 SUSTAINABILITY OF MFIs

Sustainability shows the performance of Microfinance Institutions. The performance of microfinance institutions is measured by its sustainability. Sustainability means that a microfinance institution is able to be sustained. If microfinance institutions are not sustainable it may not run for a long time. In other words, it does not give any contribution to economy development because it does not survive in future. (Schreiner 2000) Sustainability can be defined as the ability to repeat performance through time. Social sustainability and financial sustainability are two goals of MFIs. The social performance goal of microfinance institutions is reaching the poor people and becoming sustainable. Social performance delineates that how an organization is nicely obtaining its mission or special goals. The social goal may be evaluated by the outreach performance of microfinance institutions. A social sustainability may be achieved if microfinance institutions make outreach cheaper than traditional banks (Schreiner 2000). Financial sustainability shows that MFI is able to generate the finance from its operations till MFI cover all its cost. So, it may be concluded that microfinance institutions are considered sustainable if they are able to cover all their operating and financial expenses from their own generated income. Good governance is essential for outreach and profitability of microfinance institutions (Pinkowitz et al. 2006). Profitability is a high standard measure of microfinance institutions performance (Cull et al 2007; Brau & Woller 2004). It is also believed that good characteristics generate goodwill among clients of microfinance institutions. Outreach and financial sustainability are
complimentary this is because as the number of clients increases MFIs enjoys economies of scale and hence reduce costs which help them to financial sustainable (Meyer 2002). It is also argued that there is an inverse relationship between outreach and financial sustainability. Higher outreach leads to higher transaction cost in order to get information about the creditworthiness of clients and hence make microfinance institution financially unsustainable (Kereta 2007). So, this study determines the factors which affect the sustainability of microfinance institutions and examine that if outreach level increase then financial sustainability increase or decrease. We can measure the financial sustainability of microfinance institutions with operational self-sufficiency, return on assets and return on equity. Social sustainability of microfinance institutions is measured by the breadth of outreach. The breadth of outreach refers to the number of poor served by a microfinance institution (Woller and Schreiner 2002; Navajas et al 2000; Ledgerwood 1999). The number of borrowers is the biggest sustainability factor (Logotri 2006). So, a large number of clients will be helpful in microfinance institution to become more sustainable.

1.4 PERFORMANCE MEASUREMENT OF MFIs

The performance of microfinance institutions is measured by institutional characteristics, outreach (Number of active borrowers), financial sustainability, social status, efficiency and governance of microfinance institutions. Institutional characteristics of MFI include a number of offices, the number of staff members, and the number of loan officers and the assets size of MFI. Outreach of MFI includes the number of active borrowers, female borrowers and number of the loan outstanding in an MFI. Financial sustainability of MFI shows that MFI is able to cover its all expenses. The social status of MFI is measured by the range of products and services; poverty alleviation, geographical concentration and behavior of the employee. The efficiency of MFI is measured by the borrowers per staff member, cost per borrower and personnel allocation ratio etc. Efficiency shows that MFI is able to reduce their expenses on the loan portfolio. The performance of MFI is measured by the Governance of MFI. The skill of board member is very useful. Skill means the ability to work with other members, trustworthiness, willingness to participate, communication skill, microfinance industry expertise, legal skill and public relation etc.

1.5 BACKGROUND OF MICROFINANCE

The microfinance concept in India has instant attained the consideration after Muhammad Yunus won the Nobel Peace Prize for his initiatives. Studies on microfinance show that
microfinance institutions help the poor to increase income through investments in the agriculture sector and portative of alteration. In general microfinance institutions in India have at least 3 generic priorities: women empowerment, non-profit approach and focus on the rural area. Till now, its success and spread in India have been limited to the South Indian States which have a long history of thrift and credit societies and self-help groups. In the early 1970s, few experimental programs had started in Bangladesh, Brazil and some other countries. Small loans were given to the poor people till they invest in micro-business. This type of small loan was provided on the basis of solidarity group lending. In the solidarity group, every member of the group takes the responsibility of the repayment of the loan of all the members.

After 1970, many banks and financial have been exploring the microfinance programmes. These are listed below:

1.5.1 ACCION International: Accion’s leaders were beginning to focus on addressing the major causes of poverty in Latin American cities: lack of economic opportunities. In 1973, Accion staff in Recife, Brazil began to focus their efforts on helping informal businesses. If these small-scale entrepreneurs could borrow capital at commercial interest rates, they wondered, could they lift themselves out of poverty? An Accion organization in Recife called UNO coined the term “microenterprise” and began issuing small loans. These were the first loans that launched the field of microcredit. The experiment in Recife was a success. Within four years, the organization had provided 885 loans, helping to create or stabilize 1386 new jobs. Accion had found a way to generate new wealth for the working poor of Latin America (Accion n.d.).

1.5.2 SEWA Bank: The poor self-employed women’s make an association which name was self-employed women’s association. This association realized a need of finance for running the day to day business activity till they purchase some equipment for the business. This association wants to a safe place till they kept their savings. For kept their savings they go to formal banks but association realizes that this process was difficult in the formal financial institution. Self-employed women’s workers and producers are very active and they contribute in the economic growth of the country. In 1974, they articulate an idea that they promote a bank of their own and signed as promoters. For the registration process, two members were non-poor and thirteen were poor, which were the promoters. In 1974, first microfinance institution was established with the initiative of few poor self-employed women (SEWA n.d.).
1.5.3 **Grameen Bank:** Grameen bank was formed by the Muhammad Yunus. He has inspired the famine of Bangladesh in 1974. He distributes a small loan of US $27 to a group of 42 families till they make items for sale and earn money. This loan was provided on a cheap rate. He found that if this loan provides to a large population then they stimulate their business and reduce the poverty level in Bangladesh. Then he formed a Grameen bank model with his research and experience. In October 1983, an independent Grameen bank was established with the government legislation. More than 40 countries were inspired with the Grameen bank success and working on the similar project (Grameen n.d.).

The macroeconomic crisis of the early 1990s led to familiarization of economic reforms of 1991. It resulted to that greater self-sufficiency to the financial sector and also led to the emergence of new generation private sector bank viz. UTI Bank, ICICI Bank, IDBI Bank and HDFC Bank. These banks became important players in microfinance sector a decade later. Since 2000, the microfinance sector saw some acrimonious changes in many aspects while the prime objective remains poverty alleviation with new terms of inclusive growth or financial inclusion, sector moved from one mere social return approach to double layer approach of social and financial returns. Today, MFIs relate superior to the economy and see themselves as businesses in the financial service sector, catering to an untried market segment while creating value for their shareholders. The orientation of microfinance institutions is a shift from development to social entrepreneurship. This overriding shift takes some changes in institutions legal forms, capital structure, sources of funds, growth strategies and strategic alliances. Many microfinance institutions have subsequently transformed into regulated, for-profit business models and legal structure with increasing outreach and focus on profit, increasingly microfinance institutions emerged as a strategic pattern of banks, custom finance, retailers interested in reaching out of India’s low-income client segments. Indian microfinance today is a dapper space with massive of players offering various products and services to low-income clients with different approaches. A legal form such as section 25 companies, Cooperative, NBFCs, NGO-MFIs and banking system all are approaching rural markets.

1.6 **DELIVERY METHODOLOGY**

Mainly Self Help Group, Joint Liability Group, Grameen Bank and Co-operative delivery model are used by microfinance institutions in India to deliver financial services to the poor
people. These models used to depend on the legal structure of respective microfinance institutions.

1.6.1 Self Help Group Model: The SHG model was initiated by the National Bank for Agriculture and Rural Development (NABARD) through the SHG-Bank Linkage Programmed in the early 1990s. SHG model links the informal groups of women with the mainstream banking system. The SHG model has the enormous outreach of microfinance clients in the world. Ordinarily women in villages have fabricated groups of 10 to 15 members and they are excited for fabricating these types of groups. The members of this group collect their savings in the group periodically and these savings use to provide the small loans to the group members. The group members meet again when the new savings come in and take the recovery of past loans from the members and again distribute in the members. After a long period, these SHGs are able to attain the loan from the bank for income generation purpose till they increase the standard of living. This model has been very much successful in the past and with time it is becoming more popular.

1.6.2 Joint Liability Group Model: In joint liability group, the borrowers make a group among themselves, mainly 5 to 10 individual members. One person is appointed as a leader of that group between the borrowers. The members of the group are socio-economic background and usually the same villages. If one person takes the loan from MFI, each member of that group will be responsible for the repayment of the loan. In this social collateral is provided to the lending institution. In The JLGs regular savings by the members are not mandatory. The group exists only because its individual members are legally bound to one another. In this model, the progress of empowerment of group members remains very limited. In India, these types of groups are generally made by most of the MFIs because such groups are easy to make as there are very fewer restrictions regarding the utilization of loan. NABARD is using this model for providing credit to the tenant farmers, cultivating land either as oral lessees or sharecroppers, and small farmers who do not have the proper title of their land holding.

1.6.3 Grameen Bank Model: Grameen Bank model is one of the oldest and most successful models of microfinance. This model was developed in Bangladesh. It turns out that many organizations in India have adopted the Grameen Bank model with little variations and good success. In this model, the group is formed five members; they must be neighbors but not relatives. This group is observed for a month that his members confirming the rules of banks or not. If the first two borrowers repay the loan amount with interest during a time of a period
other members of the group become eligible themselves for a loan. Because of these restrictions, there is substantial group pressure to keep individual records clear. But the group is not required to give any guarantee for the loan repayment by its member.

1.6.4 Co-operative Model: Co-operatives model is created by the members who share their profits, co-operative act for their mutual interest. Under the Co-operatives, better banking and financial services provided to their members. Members participate in all the major decisions.

1.7 LEGAL STRUCTURE OF MFIs

The MFIs groups are registered as Non-Banking Financial Companies (NBFCs), societies, trusts and co-operatives. Table 1.1 shows the description of registration acts and type of institutions which come under these acts.

Table 1.1 Institution Types and Description of Registration Acts

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<tr>
<th>Institution Type</th>
<th>Description</th>
<th>Most Common Delivery Model</th>
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<tr>
<td>Society</td>
<td>Registered under the Societies Registration Act, 1860 – technically established by a group of 7 individuals with the common objective of engaging in a charitable activity with a public (non-commercial) purpose</td>
<td>SHG</td>
</tr>
<tr>
<td>Trust</td>
<td>Registered under the Indian Trusts Act, 1882 – for microfinance, mainly public charitable trusts with no individuals specified as beneficiaries</td>
<td>SHG</td>
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<tr>
<td>Saving &amp; Credit Co-operatives (SCC)</td>
<td>Established under the Multi-State Cooperatives Act of 1911 or state cooperatives laws by groups of individuals agreeing to undertake joint activities such as pooling their savings for the purpose of on-lending within or outside the group. These cooperatives operate on a for-profit basis in theory and distribute profits on the basis of an equal contribution to equity by all the members. Such cooperatives are subject to significant degrees of control by state level Registrars of Cooperatives.</td>
<td>JLG</td>
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<tr>
<td>Mutually Aided Cooperative Societies (MACS)</td>
<td>“New model” cooperatives so called simply to distinguish them from the cooperatives established under the conventional cooperative laws. Such cooperatives are not subject to any significant degree of state control. The bye-laws of MACS must adhere to cooperative principles and contain names, objectives, eligibility as well as termination criteria for membership, a division of profit and other details that govern the relationship of members amongst themselves. Unlike the conventional cooperatives, in MACS the ultimate authority of the cooperative society vests in its general body which consists of all its members. Membership is voluntary and open to all those who can make use of its services and are willing to accept the responsibilities of membership.</td>
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<tr>
<td>Urban Cooperative Banks (UCB)</td>
<td>For-profit institutions registered under the Cooperative Societies Acts of the respective states or the Multi-State Cooperative Societies Act of 2002. It must have at least 3,000 members and paid up capital and reserves of at least Rs1 lakh. UCBs have the Reserve Bank of India as their regulatory and supervisory authority for their banking operations while administrative and managerial supervision is under the jurisdiction of state level cooperative departments or the central government (for multi-state cooperatives)</td>
<td>JLG</td>
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<tr>
<td>Non-Bank Finance Companies (NBFCs)</td>
<td>For-profit companies established under the Companies Act, 1956 and required to raise a minimum equity capital of Rs. 2 crores and to register as NBFCs with the RBI</td>
<td>Grameen</td>
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Not for profit companies (Sec-25 Company)

Under Section 25 of the Companies Act, 1956 established with a purpose such as the promotion of commerce, science, art, religion, charity or any other useful purpose and, therefore, regarded as a non-commercial entity earning profits but not allowed to distribute dividends. Such companies are not required to be registered with the Reserve Bank of India provided they do not accept deposits.

Grameen

Source: Sinha (2009)

1.8 DEBATING ISSUES IN INDIAN MICROFINANCE

Many debating issues that are creating hindrance in the growth of microfinance institutions in India are outlined as under:

1.8.1 Illiteracy Rate: Illiteracy rate is one of the major hindrances in the growth of microfinance sector. Illiterate people are not aware of the MFIs policy. Many people do not know how to read but they know how to sign a policy or document. So, we can say that it is dangerous for poor people. Creating the awareness in poor people about microfinance is also difficult.

1.8.2 Non-availability of Fund: Not for profit companies, which are a major part of the microfinance sector, avail the funds from donation and grants from government and institutions like SIDBI and NABARD. In the absence of substantial funding from the equity market, the major source of funds is bank loans. If they take bank loan against their equity, their portfolio size will decrease. If they increase their portfolio size and so, they have to look for other sources of funds.

1.8.3 Retention rate of group members: Most of the MFIs disburse their loan on a past record of the group members. Which group’s member give a timely payment of loans, they are getting new loans easily. However, many members leave the group and join the other group create big problems. So, in the absence of a decent past record, members deprived of getting bigger loan amounts and additional services.

1.8.4 Number of offices: People in urban and semi-urban are already having access to microfinance through SHG-bank linkage model, but in rural areas, people do not have access to the bank. Because of the initial cost involved in serving a new location, MFIs are not
willing to open the offices in these remote areas. Most of the MFIs offices are located in urban or semi-urban areas.

1.8.5 Interest rate: In MFIs interest rate is also high. A poor people cannot pay this rate and a repayment rate of MFIs will be going down. According to RBI, margin cap is 12% for all MFIs. When a borrower cannot pay the loan, he goes to depression and in some cases forcing them to commit suicide.

1.8.6 Excess of debt: Much time in the competition, an MFI giving multiple loans to the same borrower that in some cases are leading to an excess of debt. MFIs affected by because borrowers are failing to make payments and hence their recovery rate is falling.

1.8.7 Regional Disparity: Mostly MFIs are in the southern area because banking network is strong in these areas. Nevertheless, in the northeastern region of India, banking network is limited and the coverage of MFIs is low.

1.8.8 Problem in reaching: The microfinance delivery model not focused on those people live in below the poverty line. Mostly poor people live in rural areas but MFIs not reached in these remote areas. They select non-poor people in the urban area until they achieve higher repayment rate and successfully run the MFIs. Poor people do not easily join any group because they hesitate that how they deal with other groups members.

1.8.9 Regulation of MFIs: Many types of institutions are working in the microfinance sector. These include NBFC, Banks, section-25 companies, trust & societies. But banks and NBFC are regulated by the reserve bank of India. But other MFIs are registered their respective state legislations. A single regulation system is not available for all the MFIs, which creates a weakness in the MFIs.

1.9 REFERENCES


