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To, ...
Mr. Amit Kumar, Project Director
Saipur

This is to certify that Shri./Mr./Mrs./Dr./Prof. AMIT KUMAR

Paper Entitled
"Micro Finance Bill: Abstractions and Reassurance"

has been accepted for publication.

Prof. S. N. Chaturvedi
email: snchaturvedi56@gmail.com
Chief Editor
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Dr. S.N. Chaturvedi
Professor & Head
Dept. of Economics

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Microfinance Bill: Aspirations and Fears

On 20th March 2007, the Union Government introduced the Micro Financial Sector (Development and Regulation) Bill 2007 (henceforth the Microfinance Bill) in the Lok Sabha – the lower house in the parliament of India. It represents a welcome recognition of the great potential which the micro financial sector has to assist in the national goal of financial inclusion and to add depth to India’s financial and capital markets. However, the bill also has serious shortcomings that need to be addressed for this potential to be realized. This paper aims to analyze the bill critically, point out potential perplexities that would arise as a result of it and make suggestions on making improvements to the Bill. First, we look at the context in which the Bill has been drafted.

What are Microfinance Institutions?

There is no standard definition of a microfinance institution (MFI). An MFI generally provides relatively small loans (in the Indian context, loans of less than Rs. 50,000) to low income individuals. The loans could be for income generation or for consumption. Fungibility of money makes it difficult to distinguish between the two. Sources of MFI funds however can be varied, including grants and loans from commercial banks, insurance companies, governments, foundations and others.

A Brief History of Microfinance in India

There are two main delivery channels for microfinance services. The first one is SHG (Self Help Group)-Bank Linkage Channel (SBLC), which was developed from field experiments in the early 1990s by NABARD (National Bank for Agricultural and Rural Development). NABARD was established in 1982 to promote equitable rural prosperity through credit and other initiatives.

The second channel is Microfinance Institution (MFI). The first MFI in India was set up in 1974, but the momentum was achieved only during the 1990s. Initially the formal financial institutions were reluctant to be involved with the MFIs, and social entrepreneurship was also in short supply. In recent years banks and other institutions, helped by supportive public policies, have become more aware of the commercial viability of the microfinance services. Innovative partnership models
have been developed between the banks and the MFIs. These have increased availability of funding to the sector and have subsequently enabled MFIs to increase their scale of operations and outreach.

Both the channels have witnessed healthy growth over the last five years. The cumulative number of SHGs linked to the banking system has grown many folds during the period 2001-2010. Social entrepreneurship is now getting more sophisticated and diffused leading to many financial and service delivery innovations in a decentralized manner.

**Just How Big is Microfinance in India?**

There is currently an absence of a robust database for the microfinance sector, a gap which must be addressed if the potential of this sector is to be realized, and for better public policies and regulation. According to the “Status of Microfinance in India 2009-2010” Report published by NABARD, it is estimated that there are around 1500 MFIs in India. Direct and indirect linkages between SHGs and banks under the SBLC cover around 97 million families or over 440 million persons. The combined disbursement of MFIs (incl. banks and SIDBI) and the SBLC as on March 31, 2010 was around Rs. 25181.79 Crores. This is fairly low, suggesting, considerable scope for developing the sector.

**Current Limitations of Microfinance in India**

A major gap in the services provided by the sector is that due to regulatory restrictions, savings products have not been offered until now. Financial inclusion should involve both savings and credit products. The provision of savings products will enable MFIs to offer a more complete suite of products to low income groups.

There is disproportionate reliance on group lending. The MFIs in particular need to shift from group to individual-based lending. This will require focus on development of appraisal skills and more modern management information systems.

There is scope for substantially improving the quality and efficiency of service delivery by the organizations providing microfinance services. Transaction costs, defined as lending costs exclusive of cost of funds and default costs, currently contribute significantly to the high interest rates charged to the borrowers while
relatively small size of loans and high frequency of transactions are inherent in microfinance, the challenge is to nonetheless lower transaction costs substantially.

**Some Recent Positive Developments**

To minimize the ensuing high transaction costs, a number of MFIs are experimenting with newer technologies such as smart cards. As argued by CK Prahalad, a management expert, the key to financial viability is to provide a first world product (i.e. financial services) at fraction of the cost borne by high income consumers.

The microfinance sector has begun to offer insurance, pensions and remittance products. It is anticipated that with the further deepening and broadening of India’s financial and capital markets, more complex financial products will be offered by microfinance organizations.

In response to certain undesirable practices with regard to interest rates and collection of some MFIs, Sa-dhan, the industry association of MFIs evolved a voluntary code of conduct for the sector.

Recent experiences have underlined the need for better public policies, stronger legal foundations, and more competent and professional regulation of the microfinance sector. These should however be consistent with further encouragement for social entrepreneurship and with developing all aspects of the microfinance sector, including financial education.

The discussions on an online India-centric discussion forum called Poverty and Microfinance Community of Solution Exchange facilitated by the UNDP (United Nations Development Programme) are quite nuanced and of high quality (www.soluitionexchange-un.net.in). In a large country like India such online fora represent a vital public good to disseminate ideas and practices, thereby helping to diffuse good practices quickly and widely.

**The Dharma of the Regulator**

First and foremost, a regulator’s role should be like that of a physician, to do no harm. Ideally the Bill should incorporate considerable insights and pragmatic
approach of the participants in the above forum, and ensure that such expertise is utilized effectively in the governance structure of the regulator and for the development of the sector as a whole. At the minimum, the Bill should refrain from establishing provisions that are rigid and also financially and economically counterproductive. The Bill should take into account the needs of micro-finance in the urban sector as well as the rural sector. India is rapidly becoming urbanized, and exclusive focus on the rural sector is therefore warranted. It is in the above context that the Bill is analyzed below.

**The Microfinance Bill**

The Bill seeks to promote and regulate MFOs (microfinance organizations). The definition of MFOs “includes” societies, trusts and cooperatives. The Bill designates NABARD as the regulator for the sector. Microfinance services are defined to include credit, life insurance, general insurance and pension services. While micro credit has been defined as loans not exceeding Rs.50,000 (Rs. 1,50,000 in case of housing), the other services have not been defined further.

**Proposed Changes**

Three aspects of the bill, among others, have the largest implications for the industry and thus are the focus of the discussion here.

1) **Selection of microfinance organizations**

Indian microfinance is characterized by a wide range of legal entities that engage in microfinance activities. Some important entities include, but not limited to, the following: society, trust, cooperative including urban cooperative bank (UCB) and mutually aided cooperative society (MACS), section 25 company (not-for-profit entity registered as a company) and non-bank financial company (NBFC). Not-for-profit MFIs including societies and trusts – often bundled together as NGO-MFIs – and section 25 companies are in reality not bound by any regulations as far as their microfinance activities are concerned, while cooperatives and NBFCs are governed by their respective regulations.

As microfinance becomes a crucial avenue for financial intermediation for the poor, policy makers started to realize the need for supervising microfinance activities, especially those provided by unregulated entities. Accordingly, the bill proposes to
bring societies, trusts, and cooperatives, termed microfinance organizations (MFOs), under an overarching microfinance regulation. In other words, NBFCs and section 25 companies are excluded from the purview of the bill.

2) **Mobilization of savings**

The current RBI regulation prohibits not-for-profit MFIs to mobilize savings from their clients. Technically, NBFCs are authorized to collect savings, provided they receive a minimum investment grade rating from an approved rating agency, after being in operation for at least two years. In reality, however, no NBFC to date has been achieved this status since the credit rating agencies tend to view lending to the poor and lending in rural areas to be quite risky (M-CRIL, 2005).

The bill stipulates that MFOs are authorized to collect deposits, termed “thrift,” from their members provided they satisfy certain conditions. This change is one of the major positive developments in the bill. It is often suggested that Indian microfinance is standing on one leg (Ghate et al., 2007) because most microfinance providers are, whether because of regulation or practical difficulties, unable to provide one of the two essential financial products, namely savings. It is widely acknowledged by sector experts that savings is as important, if not more, than credit for the poor. If passed, not only will the bill enable MFOs to offer their clients a much needed product, but it will also ease their funding constraint because mobilizing savings can be an inexpensive source of financing. This is often especially important for small NGO-MFIs as their weak capital structure prevents them from accessing capital markets and they are prohibited from receiving equity investments. As a result of the ability to mobilize savings, lending rates in Bangladesh are lower than in India since almost a third of their funds come from the savings of their members (Ghate et al., 2007).

3) **New regulator**

Last, but not least, an important proposal in the bill discussed in this paper is the appointment of a new regulator. The National Bank for Agriculture and Rural Development (NABARD) has been proposed as the new regulator for the microfinance sector. In this role, NABARD will also be the facilitator for systematic growth in the sector by setting sector-wide standards for customer education,
accounting, performance benchmarks and codes of conduct. The bill also provides for the creation of an Ombudsman, who settles any client complaints against MFOs.

These changes presented above may appear favorable to the sector at the first glance. However, a close look gives rise to various problems – so large that it makes us wonder whether the sector will be better off after all.

Issues

The first and foremost question that policy makers must ask themselves is the efficacy of this bill. As it was pointed out in section one of Proposed Changes, the bill leaves out from its purview NBFCs and Section 25 companies, which take up approximately 80% of microfinance loans outstanding as well as of the client base in the sector. This essentially means that the bill is relevant only for the remaining 20%.

While the scope of the bill is extremely narrow, potential negative consequences can affect the entire sector, due to the provisions in the bill for savings. In the bill, NGO-MFIs are proposed to be eligible for mobilizing public deposits. Although offering savings products to the poor is a large step towards financial inclusion, there needs to be a good balance of consumer protection and meeting clients’ demands.

According to the bill, the criteria to become a deposit taking entity are the following: the minimum capital base of Rs. 5 lakhs; a minimum of three years of operation completed; and approval from the Microfinance Development Council (MDC), an entity promoted by NABARD, as a thrift-taking organization. The relative ease of establishment, compared to becoming an NBFC, remains a grave concern for many sector experts. This is particularly worthy of consideration considering the clients are poor and are saving out of their meager incomes. On top of basic concerns, India has a history of suffering from savings related scams. Even if all NGO-MFIs are operating in good intentions, many of them are likely to lack the experience and capacity to handle the banking business. One failure can dilute the reputation of the entire industry.

The rationale for the classification of affected entities is completely unclear. One may argue that the reason for the exclusion of NBFCs from the bill is that they
are already regulated by the RBI. However, this does not explain why Section 25 companies have been left out and why cooperatives, which are currently regulated, have been included. As a result, the legal bird’s-eye view under the new bill would be strangely distorted even though the very idea of the bill is to provide an overarching legal framework for microfinance activities: NBFCs continue to be regulated by the RBI; NGO-MFIs and cooperatives regulated by NABARD and the same cooperatives by the Registrar of Cooperative Societies; and Section 25 companies remain unregulated.

There are concerns around the appointment of NABARD as the regulator of MFOs in the sector for two reasons. First, there appears to be no practical reason why microfinance must be regulated by NABARD, rather than by the RBI, which is the entity responsible for the financial system as a whole. One of the reasons posited for RBI’s hesitation in regulating the microfinance space may be the unfortunate result of RBI’s poor experience in regulating UCBs in the past. However, these fears may be misplaced since the issues pertaining to the cooperative sector are specific to its unique characteristics, rather than being applicable to the microfinance sector as a whole. Second, NABARD is also responsible for the administration of the Microfinance Development and Equity Fund, a fund created to provide equity capital, debt funds, or grants to MFOs. This clearly becomes the source of a conflict of interests with its multiple roles as a promoter and a regulator. NABARD is also envisioned as playing an ‘enabling’ role in the sector by (1) facilitating the development of credit rating norms and performance benchmarks, (2) specifying the accounting form and the auditing standards, (3) promoting financial literacy of MFO clients and sector-related research, and (4) disseminating information relating to best practices, amongst other things. While this is a worthy list of objectives and comes at a particularly pertinent time for the microfinance sector in India, there is no clear sense as to exactly how these goals are to be achieved.
Comments of different stakeholders on the Bill

Perspective of the Poor

Microfinance bill only keeps the viability of the microfinance Institutions and not the welfare of the poor.

1. The interest rates are left untouched since it was thought that the regulation will dry up funding to this sector. However, unregulated interest rates breed inefficiency/profits. The interest rates are raised to cover the costs of inefficient operators of microfinance and the profits of the efficient microfinance operators.

2. There is no competition in the microfinance sector. Poor are the captive customers of the microfinance organizations that promoted them and arrange loans for them.

3. It is beyond anybody's rational imagination to think that poor can pay 25-30% rates of interest on the loans and operate micro enterprises that give them a return of more than 30% on the investment and come out of poverty. The strangulating nature of interest rates can never ever bring them out of poverty

4. The only good thing about the microfinance is that they allow consumption loans to the group members in times of distress such as lean seasons when they do not get work and before harvest when the food grains prices are high. Microfinance at 30% rate of interest is better than 100% rate charged by moneylenders. However to get these consumption loans from the microfinance organizations many organizations force them to save continuously (Rs.1 to Rs. 5 a day irrespective of whether they get work or not). The savings are permanently locked up with the microfinance organizations and never given back to the members in lean season. Members will have to take loans and cannot avail the savings. The savings of members are used by the microfinance organization to leverage higher loan amounts from the banks.

5. The larger the amounts handled by the microfinance organizations and the larger the interest rate difference between their borrowing from the bank at 12-15% and their lending rates to self help group at 25-30% the more viable and profitable the microfinance organization.
6. But such forced savings that are never given back and paying prohibitive rates of interest only delay the down fall of the poor but ultimately keep the poor in depths of poverty.

7. The micro credit institutions should not be allowed to collect savings. Instead the savings should be allowed to be kept in banks and allowed to be withdrawn in times of distress. Facilitating saving operations are as important as giving them loans.

8. The flexibility of allowing some micro credit organizations to collect savings, compulsory nature of savings needs to be regulated.

Concerns of Women’s Organisations

A National Convention on Microfinance Sector (Development and Regulation) Bill 2007 was held in Vithal Bhai Patel House lawns, New Delhi, on May 15, 2007. More than two thousand women delegates representing self help group federations from 13 states attended the convention and expressed their reservations regarding the Bill and called upon the members of parliament to enact a Bill that takes the real concerns of women's groups into account.

The convention ended with a march to parliament and a resolution to continue the struggle for the amendment and redrafting of the present Bill. The detailed memorandum passed by the convention sought serious reconsideration of the Microfinance Sector (Development and Regulation) Bill 2007, which is pending before the Parliamentary Standing Committee on Finance. Accepting the need for regulating the microfinance sector, the memorandum however pointed out that the current draft is an instrument to weaken the autonomy and rights of Self Help Groups. It felt that the Bill is fundamentally flawed because of the following reasons:

1. It leaves non-banking financial companies and section 25 companies out of the purview of its regulatory framework.

2. It does not regulate or put a ceiling on the interest rate charged to the clients in SHGs.

3. It gives license to Microfinance Organizations to make profit out of the thrift of the poor women.

4. It weakens financial and social responsibility of banks, which will have a bad impact on the poorest of the poor.
5. It ignores the empowerment aspect of microfinance which should be an integral part of all women's self help groups.

**Civil Society Concerns**

Members of NGOs, women’s organizations and researchers working on issues related to women in Self Help Groups (SHGs) across the country have raised certain concerns about the Microfinance Sector (Development and Regulation) Bill 2007 (Bill No. 41 of 2007).

The largest stakeholders in the microfinance sector today are rural poor women whose savings form the backbone of the sector. Therefore any regulation should serve their interests and make credit accessible to them in an equitable and just manner. The main aspects that require regulation in this sector are therefore as follows:

- **The high rates of interest charged by microfinance institutions (MFIs) and microfinance organizations (MFOs).**
- **The coercive means of recovery used by them.**

The MF Bill that is currently under consideration does not address these key concerns related to the functioning of the microfinance sector. They have opposed to the Bill on these and several other counts. Below are their concerns and recommendations: (Based on provisions in current draft of the Bill in Chapter I Section 2; Chapter II Section 4; Chapter III Sections 8, 9, 10, 11 & 12; Chapter IV Section 14; Chapter V Sections 19, 20 & 21; Chapter VI Sections 22 & 23; Chapter VII Sections 24 & 25; Chapter VIII Sections 26, 27, 28 & 29; Chapter IX Sections 30, 31, 32, 33, 34, 35, 36, 37 & 38)

1. **Who should benefit from the regulation** – In keeping with the centrality of the needs of rural poor women there must be an interest cap to ensure that the right to affordable credit without collateral is ensured. Further, it is now well proven that SHGs and microfinance exclude the poorest of the poor. Hence, the bill should have provisions to ensure inclusion of women belonging to marginalized communities such as Dalits, Adivasis and Muslims.

2. **Who is being regulated** - Regulation has been proposed only for MFOs – cooperatives, societies, trusts, etc, while non-banking financial banking corporations (NBFCs) registered with the RBI and large MFIs registered as
companies have been left out. The exclusion of MFIs is unjustified because they are large profit-making bodies and have been reported to have used various forms of coercion against women borrowers.

3. **Why is there even a need for regulation** – There exist legislations as well as RBI guidelines for MFOs, MFIs and NBFCs. There are also guidelines for regulating insurance services under IRDA. Is there a need for additional regulation?

4. **Why has thrift collection been opened up** - The Bill permits any organization with Rs.500000 capital to accept thrift. This means that any unscrupulous organization – including communal organizations and corporates - can mobilize thrift, or even abscond with deposits of the poor. It is not advisable to allow MFOs to collect thrift. Savings of members should be deposited in banks in order that they have greater control over their own savings rather than that control being vested in the hands of an external agency.

5. **Who is the proposed regulator** – NABARD, as a promoter of microfinance, cannot also be the regulator since it would lead to conflict of interest. The current bill accords NABARD arbitrary and draconian powers as a regulator in the proposed framework. They propose that regulatory authority be vested in autonomous bodies at the Centre, State and District levels comprising of representatives from SHG federations, banks, MFOs, MFIs, SIDBI, Rashtriya Mahila Kosh and NABARD.

6. **Why is there a limit on the loan amount** - The ceiling of Rs.50000 on individual loans for micro enterprise is not justified. Research shows that failure of micro enterprise has been primarily due to lack of working capital and capacity building.

7. **Why do MFOs need registration with NABARD** – MFOs are already functioning under one or other legal status. They should not be asked to register again with NABARD.

8. **Why should non-profit MFOs contribute ‘profit’/’surplus’ to a Reserve Fund** – There is a false assumption that MFOs are profit-making bodies that should contribute to a Reserve Fund. There is a need for a Microfinance Development Fund, as proposed, but it should not be managed by NABARD.
alone. Rather, the more representative Microfinance Development Council should collectively set norms and handle management tasks related to this Fund.

**Conclusion**

In last few years in India, there have been a large number of policy measures introduced to facilitate access to finance for low income sections of society who continue to remain excluded from the ambit of formal finance. Microfinance has long been acknowledged as an important way to promote financial inclusion. Its social benefits have also been widely publicized by policymakers, practitioners and researchers. A bill that creates an enabling environment for microfinance institutions would be a welcome relief for practitioners. The proposed bill, however, seems to have failed to provide this environment. The new classification of regulated entities may well augment rather than ameliorate the complications the sector faces today. The appointment of NABARD as a regulator seems like a recipe for a political, factional discord. Admittedly, the fact that the bill authorizes MFOs to mobilize savings is progress in the right direction, but more stringent standards are required if there is to be adequate consumer protection. If microfinance is to have considerable impact on the poor in providing them a foothold for financial inclusion, substantial revisions in the scope of the bill is called for.

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प्रतियोगिता दृष्टि

केंद्रीय बजट
2011-12

भारत में माइक्रोफायडर्स संस्थाओं की समस्याएं
हिन्द महासागर में उभरे जा रहे सामरिक समस्याकरण

राष्ट्रीय | अंतरराष्ट्रीय | अर्थव्यवस्था | राजव्यवस्था | इतिहास-संस्कृति | विज्ञान-प्रौद्योगिकी
प्रमाण पत्र

प्रमाणित किया जाता है कि श्री अमित कुमार द्वारा लिखित लेख “भारत में गाइकों फाइनेंस संस्थाओं की समस्याएँ” को प्रतियोगिता दृष्टि के मार्च 2011 के अंक में प्रकाशित करने के लिए स्वीकार किया जाता है।

12 जनवरी 2011

(सूरजमान सिंह चारण)
सापारक
प्रतियोगिता दृष्टि संपादक
प्रतियोगिता दृष्टि
अर्थव्यवस्था

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भारतीय एपिफ्युअल को कार्य की सहायता देना चाहते हैं।

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एयमकाउन्ड के लिए ऐसे लोगों की जगत है, जो पर्यावरण हो, उनके लोगों से पूर्व-मिलों की प्रभाव हो और ये प्रभाव और विवेकों की पूरी तरह से समझ कर सुधर सकें। लेकिन युगाधिकृत आमिर तो वह भी तो जीवन रहने के लिए उपचार नहीं है। योग संवाद और विवेक के लिए रखी है कि उन्हें अविचारित जन्म के सम्बन्ध में जीवन की जीवन का भी जीवन पाए।

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अर्थव्यवस्था
करने के लिए जरूरी आवश्यकता है— 1. सूचना आपके और आपकी योजना, 2. प्रश्न पत्र, 3. व्यावहारिक प्रबंधन, 4. व्यावसायिक प्रबंधन, 5. व्यवसाय समझ। ऐसा विषय कि इस क्षेत्र में आप जान सकते ग्लोबल व्यावसायिक नियोजन की तुलना में व्यावसायिक नियोजन है। व्यावसायिक संस्थाओं में आपके आवश्यकता नियोजन द्वारा एसी समस्या पर विचार किया जाता है।