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Microfinance – Recent Issues and Trends in India

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Abstract: Microfinance sector has grown rapidly over the past few decades. Nobel Laureate Muhammad Yunus is credited with laying the foundation of the modern MFIs with establishment of Grameen Bank, Bangladesh in 1976. Today it has evolved into a vibrant industry exhibiting a variety of business models. Microfinance Institutions (MFIs) in India exist as NGOs (registered as societies or trusts), Section 25 companies and Non-Banking Financial Companies (NBFCs). Commercial Banks, Regional Rural Banks (RRBs), cooperative societies and other large lenders have played an important role in providing refinance facility to MFIs. Banks have also leveraged the Self-Help Group (SHGs) channel to provide direct credit to group borrowers. With financial inclusion emerging as a major policy objective in the country, Microfinance has occupied centre stage as a promising conduit for extending financial services to unbanked sections of population. At the same time, practices followed by certain lenders have subjected the sector to greater scrutiny and need for stricter regulation.

Keywords: Microfinance, MFIs, Banking, Rural, SHGs.

I. INTRODUCTION

“Microfinance is the provision of financial services to low-income clients or solidarity lendinggroups including consumers and the self-employed, who traditionally lack access to banking and related services.”

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.

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

II. FINANCIAL SYSTEM & MICROFINANCE

Microfinance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the retail finance model prevalent in mainstream banking.

For some, microfinance is a movement whose object is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers."[1] Many of those who promote microfinance generally believe that such access will help poor people out of poverty, including participants in the Microcredit Summit Campaign. For others, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

III. MICROFINANCE & POVERTY

In developing economies and particularly in rural areas, many activities that would be classified in the developed world as financial are not monetized: that is, money is not used to carry them out. This is often the case when people need the services money can provide but do not have dispensable funds required for those services, forcing them to revert to other means of acquiring them. In their book The Poor and Their Money, Stuart Rutherford and Sukhwinder Arora cite several types of needs:

Lifecycle Needs: such as weddings, funerals, childbirth, education, home building, widowhood and old age.
Personal Emergencies: such as sickness, injury, unemployment, theft, harassment or death.

Disasters: such as fires, floods, cyclones and man-made events like war or bulldozing of dwellings.

Investment Opportunities: expanding a business, buying land or equipment, improving housing, securing a job (which often requires paying a large bribe), etc.[3]

People find creative and often collaborative ways to meet these needs, primarily through creating and exchanging different forms of non-cash value. Common substitutes for cash vary from country to country but typically include livestock, grains, jewelry and precious metals. As Marguerite Robinson describes in The Micro finance Revolution, the 1980s demonstrated that "micro finance could provide large-scale outreach profitably," and in the 1990s, "micro finance began to develop as an industry" (2001, p. 54). In the 2000s, the micro finance industry's objective is to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty. While much progress has been made in developing a viable, commercial micro finance sector in the last few decades, several issues remain that need to be addressed before the industry will be able to satisfy massive worldwide demand. The obstacles or challenges to building a sound commercial micro finance industry include:

- Inappropriate donor subsidies
- Poor regulation and supervision of deposit-taking micro finance institutions (MFIs)
- Few MFIs that meet the needs for savings, remittances or insurance
- Limited management capacity in MFIs
- Institutional inefficiencies
- Need for more dissemination and adoption of rural, agricultural micro finance methodologies

Microfinance is the proper tool to reduce income inequality, allowing citizens from lower socio-economical classes to participate in the economy. Moreover, its involvement has shown to lead to a downward trend in income inequality (Hermes, 2014).[4]

IV. MICROFINANCE AND SOCIAL INTERVENTIONS

There are currently a few social interventions that have been combined with micro financing to increase awareness of HIV/AIDS. Such interventions like the "Intervention with Microfinance for AIDS and Gender Equity" (IMAGE) which incorporates microfinancing with "The Sisters-for-Life" program a participatory program that educates on different gender roles, gender-based violence, and HIV/AIDS infections to strengthen the communication skills and leadership of women [52]"The Sisters-for-Life" program has two phases where phase one consists of ten one-hour training programs with a facilitator with phase two consisting of identifying a leader amongst the group, train them further, and allow them to implement an Action Plan to their respective centres.

Microfinance has also been combined with business education and with other packages of health interventions.[53] A project undertaken in Peru by Innovations for Poverty Action found that those borrowers randomly selected to receive financial training as part of their borrowing group meetings had higher profits, although there was not a reduction in "the proportion who reported having problems in their business".[54] Pro Mujer, a non-governmental organisation (NGO) with operations in five Latin American countries, combines microfinance and healthcare. This approach shows, that microfinance can not only help businesses to prosper; it can also foster human development and social security. Pro Mujer uses a "one-stop shop" approach, which means in one building, the clients find financial services, business training, empowerment advice and healthcare services combined.[55]

V. MISSION DRIFT IN MICROFINANCE

Mission drift refers to the phenomena through which the MFIs or the micro finance institutions increasingly try to cater to customers who are better off than their original customers, primarily the poor families. Roy Mersland and R. Øystein Strøm in their research on Mission Drift suggest that this selection bias can come not only through an increase in the average loan size, which allows for financially stronger individuals to get the loans, but also through MFI's particular lending methodology, main market of operation, or even the gender bias as further mission drift measures.[58] And as it may follow, this selective funding would lead to lower risks and lower costs for the firm.

However, economists Beatriz Armendáriz and Ariane Szafarz suggests that this phenomenon is not driven by cost minimization alone. She suggests that it happens because of the interplay between the company's mission, the cost differential between poor and unbanked wealthier clients and region specific characteristics pertaining the heterogeneity of their clientele.[59] But in either way, this problem of selective funding leads to an ethical tradeoff where on one hand there is an economic reason for the company to restrict its loans to only the individuals who qualify the standards, and on the other hand there is an ethical responsibility to help the poor people get out of poverty through the provision of capital.

VI. CONCLUSION

The regulation was not a major concern when the microfinance was in its nascent stage and individual institutions were free to bring in innovative operational models. However, as the sector completes almost two decades of age with a high growth trajectory, an enabling regulatory environment that protects interest of stakeholders as well as promotes growth, is needed. In addition to proper regulation of the microfinance sector, field visits can be adopted as a medium for monitoring the conditions on ground and

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initiating corrective action if needed. It has been seen that in lieu of reducing the initial cost, MFIs are opening their branches in places which already have a few MFIs operating. Encouraging MFIs for opening new branches in areas of low microfinance penetration by providing financial assistance will increase the outreach of the microfinance in the state and check multiple lending.

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