MAKING A MAJOR IMPACT WITH MICROFINANCE

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Research paper

Microfinance brings the power of credit to the grassroots by way of loans to the poor, without requirement of collateral or previous credit record. Experience shows that microfinance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. It can als'o be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change. As organizations ranging from the 'World Bank to privately funded enterprises devote more resources to micro finance initiatives, business schools are responding by offering electives and programs designed to teach students how to function in this specialized area of business. According to Michael Chu, senior lecturer at Harvard Business School in Cambridge, Massachusetts, "Microfinance is a leading example of why business schools have a huge role to play in impacting global poverty. The bulk of global poverty is concentrated in the'developing world, which is where the state and the government have many challenges in functioning well. That leaves an enormous space for business."

Some schools teach microfinance as a component of social enterprise, a way of doing good through business. Others focus on its commercial applications- the high rate of return on loans, the profit potential inherent in partnering with the poor. No matter what the approach, those in the vanguard see the topic as one that is critical to business, business schools, and the world. *"lfYou are Uplifting The Poor Your Uplifting The Nation" Mahatma Gandhi* The microfinance revolution began when Bangladeshi economics professor Muhammad Yunus first handed over a few dollars to an impoverished basket weaver in 1974. Since then, the movement toward microfinanc -the granting of very small loans to the poorest people in the world to enable them to run small businesses that will lift them out of poverty-has won passionate supporters across the globe. Last year, Yunus and the micro finance institution he founded, Grameen Bank, shared the Nobel Peace Prize. Poverty is multi-dimensional, and by providing access to financial services, microfinance plays an important role in the fight against the many aspects of poverty. Access to credit allows poor people to take advantage of economic opportunities - for their homes, their domestic environments and their communities. For instance, income generation from a business helps not only the business activity expand but also contributes to household income and its attendant benefits on food security, children's education, etc.)"kJreo'\"e£" for women who, in many contexts, are secluded from public .iih formal institutions can also build confidence and empowerment.

About Aficrojinance

Micro Finance is the supply of loans, savID:g:s, a=! financial service to the poor

To most, micro finance means providing v ry poor families willi very small loans (micro credit) to help them engage in productive activities or grow their tiny businesses. The modem micro finance movement dates back to the 1970s when experimental programs in Bangladesh, Brazil, and a few other countries began to extend tiny loans to groups of poor women to invest in micro enterprises By lending to groups of women where every member of the group guaranteed the repayment of all members, these micro credit programs challenged the prevailing conventional wisdom and proved that poor people wi hout collateral could be "credit worthy". When offered the opportunity, they would repay loans with interest, at extraordinary rates of repayment. Micro finance refers to loans, savings, insurance, transfer se17vices and other financial products targeted at low-income clients. Micro credit

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refers to a small loan to a client made by a bank or other institution. Micro credit can be offered, often without collateral, to an individual or through group lending. *Evolution of Micro finance in India* The strength of the micro finance organizations (MFOs) in India is in the diversity of approaches and forms that have evolved over time. In addition to the home-grown models of SHGs and mutually aided cooperative societies (MACS), the country has learned from other micro finance experiments across the world, particularly those in Bangladesh, Indonesia, Thailand, and Bolivia, in terms of delivery of microfinancial services. Indian organizations could also learn from the transformation experiences of these micro finance initiatives. In the past few years, Indian microfmance has seen unprecedented growth.. For . during 2005-6, major Indian microfinance institutions (MFIs1 “”ere able to active borrower base by about 110 per cent making the sector one of the fustiest grouting world wide. Microfinance approach is based on certain proven truths which are not always recognized.

These are: That the poor are bankable; successful initiatives in micro finance demonstrate that there need not be a trade off between reaching the poor and profitability - micro finance constitutes a statement that the borrowers are not ‘weaker sections’ in need of charity, but can be treated as responsible people on business terms for mutual profit - That almost all poor households need to save, have the inperent capacity to save small amounts regularly and are willing to save provided they are motivated and facilitated to do so - That easy access to credit is more important than cheap subsidised credit which involves lengthy bureaucratic procedures - (some institutions in India are already lending to groups or SHGs at higher rates - this may prevent the groups from enjoying a sufficient margin and rapidly accumulating their own funds, but members continue to borrow at these high rates, even those who can borrow individually from banks) -‘Peer pressure’ in groups helps in improving recoveries. Micro finance has been in practice for ages (though informally). Legal framework for establishing the co-operative movement set up in 1904. Reserve Bank of India Act, 1934 provided for the establishment of the Agricultural Credit Department. Nationalization of banks in 1969 Regional Rural Banks created in 1975. established as an apex agency for rural finance in 1982. Passing of Mutually Aided Co-op. Act in AP in 1995.

Micro Finance Scenario. Estimated that 350 million people live Below Poverty Line This translates to approximately 75 million households. Annual credit demand by the poor in the country is estimated to be about Rs. 60,000 crores. Cumulative disbursements under all micro finance programmes is only about Rs. 5000 crores.(Mar. 04) Total outstanding of all micro finance initiatives in India estimated to be Rs. 1600 crores. (11arch04) Only poor about 5% of rural have micro finance to access Considerable gap between demand and supply for all financial services 11ajority of poor are excluded from financial services. This is due to, inter-Alia, the following reasons Bankers feel that it is fraught with risks and uncertainties. High transaction costs . Unfavourable policies like caps on interest rates which effectively limits the viability of serving the poor.

. While 11FIs have shown that serving the poor is not an unviable proposition there are issues that have constrained MFIs while scaling up. These **include** . Lack of an appropriate legal vehicle . Limited access to equity . Difficulty in accessing low cost on-lending funds (as of now they are unable to offer savings services in a legitimate . Limited access to Capacity Building support which is an important variable in terms of quality of the portfolio, 1118, and the sustainability of operations. . About 56 % of the poor still borrow from informal sources. . 70 % of the rural poor do not have a deposit account . 87 % have no access to credit from formal sources. Less than 15 % of the households have any kind of insurance. . Negligible numbers have access to health insurance *Features of Indian Micro Finance* . About 60 % of the MFIs are registered as societies. . About 20 % are Trusts . About 65 % of the MFIs follow the operating model of SHGs. . Large concentration in South India . 600 MFI initiatives have a cumulative outreach of 1.25 crare poor households . NABARD’s bank linkage program has cumulatively reached a total of 9.4 lakh SHGs with about 1.4 crore households. . Annual growth rate of about 20 % during the next five years. . 75 % of the total poor households of 80 million (i.e. about 60 millic .:: be reached in the next five years. . The loan outstanding will consequently grow from the present level of about 1600 crores to about 42000 crores The main features of the micro-finance services being provided by Rashtriya Mahila Kosh are : 1. It is a tool for empowerment of the poorest; the higher the income and better the asset position of the borrower, the lower the incremental benefit from further equal doses of micro-credit is likely to be. 2. Delivery is normally through Self Help Groups (SHGs). 3. It is essentially for promoting self-employment; the opportunities of wage employment are limited in developing countries - micro finance increases the productivity of self-employment in the informal sector of the economy - generally used for

(a) direct income generation (b) rearrangement of assets and liabilities for the household to participate in future opportunities and (c) consumption smoothing. 4. It is not just a financing system, but a tool for social change, specially for women - it does not spring from market forces alone - it is potentially welfare enhancing -there is a public interest in promoting the growth of micro finance - this is what makes it acceptable as a valid goal for public policy.

5. Because micro credit is aimed at the poorest, micro- fmance lending technology needs to mimic the informal lenders rather than the formal sector lending. It has to provide for seasonality. (b) allow repayment flexibility (c) eschew bureaucratic and legal formalities (d) fix a ceiling on loan sizes.

Micro Credit and RBI **RBI** defines Micro Credit as: Micro Credit is defined as provision of thrift, credit and other financial services and products of very small amount to the poor in rural'r semi-urban and urban areas for enabling them to raise their income levels and improve living standards. Micro Credit Institutions are those which provide these facilities.

DO RBI ENFORCE INTEREST RATES?

.No. The reform of the interest rate regime has constituted an integral part of the financial sector reforms initiated in our country in 1991. In consonance with this reform process, interest rates applicable to loans given by banks to micro credit organizations or by the micro credit organizations to Self-Help Groups/ member-beneficiaries has been left to their discretion. The interest rate ceiling applicable to direct small loans given by banks to individual borrowers, however, continues to remain in force.

DO RBI IMPOSE THE TERMS & CONDITIONS FOR ACCESSING MICRO CREDIT?

. No. Banks have been given freedom to formulate their own lending norms keeping in view ground realities. They have been asked to devise appropriate loon and savings products and the related terms and conditions inclosing of loan, unit cost, unit size, maturity period, grace peril margins, ere

IS FOREIGN INVESTMENT ALLOWED IN MICRO CREDIT PROJECTS?

. Govt. of India with their notification dated August 29, 2000 have included 'Micro Creditl Rural Credit' in the list of permitted non-banking financial company (NBFC) activities for being considered for Foreign Direct Investment (FDI)/Overseas Corporate Bodies (OCB)/Non-Resident Indians (NRI) investment

to encourage foreign participation in micro credit projects. This covers credit facility at micro level for providing finance to small producers and small micro enterprises in rural and urban areas

Successful Micro Finance Models That Have Emerged In India

. An Intermediate Model that works on banking principles with focus on both savings and credit activities and where banking services are provided to the clients either directly or through SHGs; . There is also a Wholesale banking Model where the clients comprise NGOs, MFIs and SHG Federations. This Model involves a unique package of providing both loans and capacity building support to its partners; and - Further, there is an Individual Banking-based Model that has its clients as individuals or joint liability groups. While programme management and client appraisal in this Model may be a challenge, it is best suited to lending to enterprises.

Challenges For Microfinance In India

. Appropriate legal structures for the structured growth of fF operations . Ability to access loan funds at reasonabl)' lQW rnres f . Ability to attract and retain professional and committed hmnan resources.. . Design of apt MIS including user friendly software for tracking accounts and operations. . Ability to innovate, adapt and grow. . Bring out a compendium of small and micro enterprises for the MF clients. . Identify and prepare a panel of locally available trainers. . Ability to train trainers. Capacity to provide backward linkages or create support structuresior marketing . Designing financially sustainable models

R E F E R E N C E

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