Providing Financial Services to the Poor on a Sustainable Basis- The Micro Finance Way

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Abstract

Micro-finance attempts to unleash forces transforming lives from debt-driven to self-driven, so to cause and trigger growth in rural economics. The focus of micro-finance is to facilitate the shift from induced development from the above to initiated development from below that is likely to change the role of bank credit in the rural segment in India. More than one-third of credit needs in the rural areas are still met by informal and high cost resources such as money-lenders, landlords, friends and relatives, and as such, the scope for the micro-finance to make inroads in rural segment is quite enormous. There is a need to make Micro-finance lending to MFIs an attractive business proposition for potential lenders, as the huge demand for financial services by the poor can largely be satisfied through mobilizing capital from the formal sector. In addition to credit/financial inputs, injecting managerial inputs into the activities of the target groups would be required, as credit alone may not yield the expected results. This is possible only through close interaction with the target groups. Expansion of micro-credit programme by retaining all the distinctive managerial aspects is also a challenge to be squarely met.

Key words: *Financial Services, Micro-Finance, NABARD, Risk Management, Self-Help Group.*

Introduction

Micro-finance can be defined as providing credit, thrift and finance related services and products of very small amount so as to improve the living standards of poor and downtrodden. A number of small enterprises can be covered under these social-oriented entrepreneurial activities. This concept is based on the understanding that the poor are bankable and micro-enterprise finance through repayment incentive structure, streamlined administration and market base pricing adopting profit centre approach is sustainable. This approach leads to major changes in a cumulative cause triggered by credit to rural masses as well as Small and Medium Enterprises (SMEs) to the ultimate benefit of rural economics.

Micro-finance provides a wide range of financial services to the poor on a sustainable basis and is slowly but steadily gaining popularity. Micro-finance service is provided primarily through the following:

I. Formal institutions- Regional Rural Bank, Cooperatives,
II. Semi-formal institutions- Non-government Institutions; and
III. Informal sources- Moneylenders and Shopkeepers.

As far as rural economy is concerned, agriculture contributes more than 20 per cent of GDP, provides employment to 57 per cent of country's workforce and ensures livelihood support to nearly two-thirds of country's growing population. Agricultural activities support rural economy through both backward and forward integration/linkages. Micro-financing is to focus on economically active poor sectors so that there is no downward migration for them.

Free market economic principles can be used to change the lives of the poor. One has to take a new idea and use information technology as well as the investment banking clout to take it forward. Micro-finance is growing very rapidly and getting its due attention from banks, financial institutions, Non-Government Organizations (NGOs) and the government.

Commercial banks encourage newer concepts such as micro-credit, formation of self-help groups and credit linking such as SHGs with a view to minimize the transaction cost in rural lending. Besides low intermediation cost, these strategies have twin advantages of high recovery rate and higher frequency of recycling of funds. Cohesive group discipline and peer pressure are the intrinsic strength of the micro-financing activities through SHG.

Role of Self-Help Group

The Self-Help-Group (SHG) is a registered or unregistered group of micro entrepreneurs having a homogenous social and economic background, voluntarily coming together to save small amounts regularly, to mutually contribute to a common fund and to meet their emergency needs on mutual help basis. The group members use the collective wisdom and peer pressure to get things done properly. The SHG platform is built up on the premise that the poor have the capacity to save, the poor need credit and not charity. Thrift comes first and credit comes later. All for each and each for all would enhance the team spirit.

The Indian micro-finance sector presently consists of a variety of micro-finance service providers, comprising of apex financial institutions like NABARD and SIDBI, Government owned societies like Rashtriya Mahila Kosh, formal ones like commercial banks, regional rural banks, mutually aided co-operative societies, SHG federations, private sectors like NBFCs, money lenders, etc. At present, there is no one appropriate form of legislation for institutions undertaking micro-finance activity.

As the demand for micro-finance has been increasing, in 1992, NABARD took pro-active steps and launched a pilot project of Self Help Group (SHG)-Bank linkage programme. In this regard, the RBI on its part, provided a supportive policy framework so as to create an atmosphere for enabling the growth of micro-finance sector.

NABARD had managed a Micro-Finance Development Fund of Rs.100 crore and it is disbursed for capacity building in the Micro-Finance Institutions (MFIs). In the budget of Feb 2005, it was increased to Rs. 200 crore and it was re-designed as "Micro-finance Development and Equity Fund" so as to infuse capital fund to some of the MFIs.

There is a broad division of responsibility in Micro-finance between NABARD and SIDBI to the effect that while NABARD oversees the linking programme of banks to SHGs and offers refinance for it, SIDBI lends to MFIs through SIDBI Foundation for Micro-credit. The credit linking of banks with SHG is a success story of micro-finance worldwide, notwithstanding the fact that qualitative changes are to be carried out and there is a long way to go quantitatively. The SHG model is based squarely on the accumulation of member savings both as an end in itself and as a means to leverage bank loans.

NABARD has been set up for duly addressing and catering to the credit requirements for agricultural and rural sectors. It has been making significant and vital contribution at wholesale level in building up micro-finance institutions. It has also activated a framework for developing SHGs as community-based financial structures and using them as channels for lending by the formal banking system. In addition to the SHG-bank linkage programmes, NABARD operates a Bulk-Lending Scheme for supporting NGO initiatives involving alternative credit delivery mechanisms.

As far as the banks are concerned, SHGs are very cost-effective because they don't have to deal with various customers and serve as an efficient recovery medium, as could be made out from the fact that the percentage of recovery is 95% and above.

Requirement of Micro-Finance Clients

Micro-finance is a bottom-to-top approach to spread credit among the poorest sections of populace for their uplift. The demand for micro-finance support originates both from the household for consumption needs and micro-enterprises for small business activities. They need quick and prompt financial support. As the income stream is normally small and erratic, micro-finance clients need very flexible repayment schedule that may not be comparable to the normal commercial aspects. It is all about making available a broad range of financial services such as deposits, loans, payment services, money transfer, insurance etc., to the poor and their business activities. In addition to normal financial support in the form of easy savings and borrowing arrangements, they need insurance cover to protect themselves and their belongings, houses, crops etc. from the vagaries of life.

Despite large bank branch networks, the finance facilities are not easily accessible to the rural folks mainly because of the 'alien culture' of the branch level functionaries, who are working on rotational basis and are not very sensitive to the local requirements and needs. Thus, there should be locally available single financing agency, easily accessible, having local language familiarity and understanding. As the majority of micro-finance clients are rather illiterate or barely literate, they would prefer simple procedures coupled with minimum paperwork.

It is often said that among the poor, many borrow, few save and all need insurance cover as a risk mitigating measure. There is a need for holistic treatment of all these products from single window.

As micro-credit has proved to be a catalyst for empowering the poor, such programmes have to be encouraged and boosted with all the vigour till the weaker sections of the community are reasonably empowered. It is noticed that even though demand for micro-credit has been on the increase, problems continue to mar the supply of adequate credit to the sector.

With significant growth in micro-finance activities, the effective benefit would spread to various aspects such as literacy, empowerment, entrepreneurship, employment, improvement in living standards, development of rural economy and finally poverty elimination, and would help bring down the numbers below the poverty line.

Risk Management in Micro-Finance

As in commercial activity, risk is inherent in micro-finance, particularly when there are no collaterals to fall back on. Today; the risk management in micro-finance has assumed greater significance as banks are preparing to comply with the related Basel II norms. The portfolio of micro-finance is primarily exposed to credit risk, which is nothing but default/diminution in the credit amount released and operational risk, which is the risk of loss resulting from inadequate or failed internal process, people and system or from external events. An element of market risk, which is prevalent in normal commercial activity, is significantly absent, perhaps owing to lower value of the product output, which is marketed through retail arrangement. The primary risk type in micro-finance activities is the Operational Risk.

As lending through SHG by commercial banks is increasing there is need to adopt a robust portfolio approach in this regard since the SHG lending is outside the purview of individual credit risk rating framework that are prevalent in banks. This will help in monitoring the outstanding SHG lending portfolio. There can be no doubt that lenders may spread their risk when they lend to this particular sector.

A study conducted by the Indian Bank in some parts of Tamil Nadu revealed that the identified factors having high risk are clubbing too many government programmes, higher than required loan size, frequent switchover of the field staff, lack of monitoring, non-transparent deals devoid of good governance, etc., by the SHG/NGOs, as a large number of activities are conducted through SHGs, the quality has victim of quantity mainly because of the inadequate supervisory mechanism. The problems faced by SHG could not be nipped in the bud. Some of the risk-mitigating measures in the micro-finance through SHG are as follows:

- Encourage short-term loans to build credit track record history.
- Better to maintain peer pressure by making the loan available only for part of the SHG group so that it is not shared by all in the group.
- SHGs to take up restructuring exercise.
- Migration from group to individual loan after imparting certain amount of training.
- Active SHG leaders are to be identified as Field Officials to prevent the staff turnover, but rotation of leaders should be ensured.
- Transparency and good governance are put in place for ensuring end use of funds.
- Proper MIS is to be ensured for regular flow of information on the functioning of the unit financed through micro-finance so as to have supervision/monitoring.

- A structured risk assessment model may be evolved to capture the risk at least on a half-yearly basis.
- In a tie-up with a national insurance company, micro-insurance product may be offered to the SHGs as a cover to protect the life/non-life risks.
- Quality internal audit system should be put in place and the important needs to be explained to the SHG members.
- Identify the auditable and non-auditable risks faced by MFIs and try to minimize the non-auditable risks.
- Create industry-wise bench marks on the basis of historical performances.

An internal study group appointed by the Reserve Bank of India to study the issues pertaining to rural credit and micro-finance has suggested two model-based approaches to deliver the credit to micro- finance clients-Business Correspondence Model for financial services and the Business Facilitator Model for non-financial matters - so as to streamline the credit delivery mechanism.

E-banking offers tremendous opportunity to combat the bankers concern of high volume of low value transactions. It would increase the volume of business while driving down the marginal cost. New technologies facilitate more information and reduce as well as spread risk.

The MFIs can act as pass-through agents for the financial transactions of banks and certain NGOs or popular individuals can assist the banks in the non-financial transactions. Nevertheless, as micro- finance is a specialized activity, it may be asking for too much to expect commercial banks to focus attention on rural poor Even Regional Rural Banks and Local Area Banks have not been able to rise to the occasion in this regard.

Recognition for Micro-Finance

There is a need to make Micro-finance lending to MFIs an attractive business proposition for potential lenders, as the huge demand for financial services by the poor can largely be satisfied through mobilizing capital from the formal sector. In addition to credit/financial inputs, injecting managerial inputs into the activities of the target groups would be required, as credit alone may not yield the expected results. This is possible only through close interaction with the target groups. Expansion of micro-credit programme by retaining all the distinctive managerial aspects is also a challenge to be squarely met.

When the borrower changes from passive recipient to active owners, then the development initiatives yield result. Entry of public sector banks in micro-finance may to a large extent, bring forth changes in the life of the poor, given the kind of branch network and the reach they have, resulting in distribution of default risk.

Micro-Finance Intervention

The Indian operating style of funding various projects/ schemes/proposals is based on the following figure, which is self-explanatory.

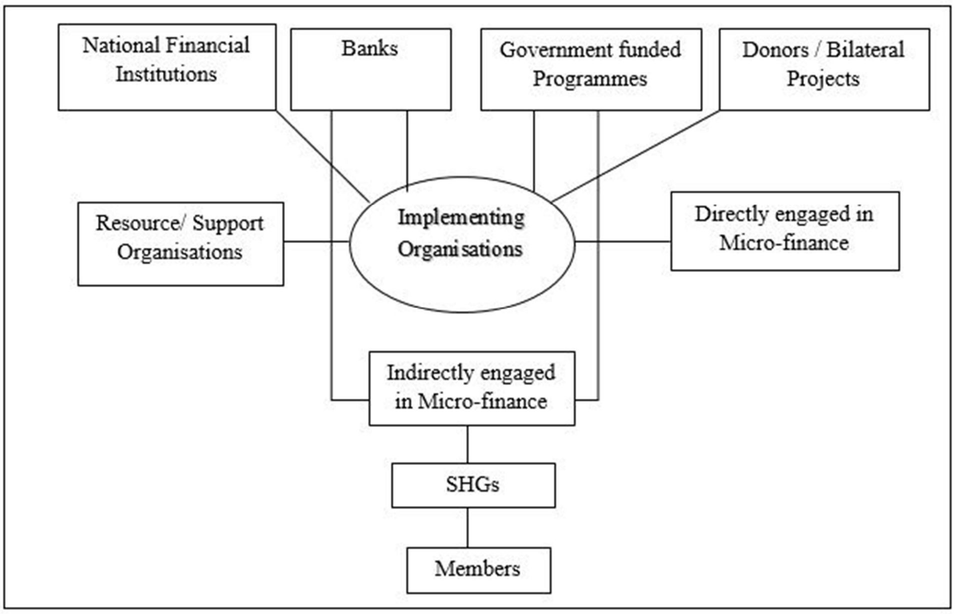

Figure 1: Micro-finance Interventions through Different Organisations

Conclusion

Micro-finance attempts to unleash forces transforming lives from debt-driven to self-driven, so to cause and trigger growth in rural economics. The focus of micro-finance is to facilitate the shift from induced development from the above to initiated development from below that is likely to change the role of bank credit in the rural segment in India, more than one-third of credit needs in the rural areas are still met by informal and high cost resources such as money-lenders, landlords, friends and relatives, and as such, the scope for the micro-finance to make inroads in rural segment is quite enormous.

Though India has made certain progress in roads and in the field of micro-finance, making inroads in rural segment is quite an enormous task. Despite of having a remarkable progress, there are some vital issues that need to be addressed viz.

- ✓ Scaling up the SHG with both forward and backward linkages.
- ✓ Capacity building and holistic approach to handle SHG.
- ✓ Setting up a supervisory body like National Centre for Excellence in Micro-Finance.

- ✓ Streamline legal framework to remove the infirmities, documentation, stamp duty, records and books of account, grading of SHGs.
- ✓ Ensure better co-ordination between the formal financial institutions and the informal ones such as MFIs.
- ✓ Encourage setting up of adequate non-governmental organizations, voluntary agencies etc.
- ✓ Sensitize the banking sector to view micro-finance as a commercially viable business proposition so as to leverage their network.
- ✓ Formulate innovative schemes to finance micro-enterprise through the largest postal network in India as there is good penetration and hands-on approach available.

All said and done, both the mainstream financial institutions and micro-financial institutions are required to play an increasingly important and prominent role in nourishing and developing micro-finance sector as social obligation. Credit needs of the poor are increasingly met from the emergence of a wide range of semi-formal micro-finance initiatives. Considering various advantages, particularly the financing of the rural poor, low transaction cost and better recovery performance, the banks have a great role to play in the micro-finance sector. Unless the poor have access to financial services to meet their needs for consumption and productive activities as also for meeting emergencies, any development assistance would not be sustainable. The unparalleled banking network in India offers an excellent opportunity to accelerate, deepen and improve the accessibility of financial services to the poor and to put in place an inclusive and robust sustainable financial system to help the poor to come above the property line.

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