AN EVALUATION OF MICROFINANCE IN INDIA

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ABSTRACT

Microfinance emerged as a noble substitute for informal credit and an effective and Powerful instrument for poverty reduction among people, who are economically active, but financially constrained and vulnerable in various countries. Microfinance covers a broad range of financial services including loans, deposits and payment services and insurance to the poor and low-income households and their micro enterprises. Microfinance institutions have shown a significant contribution towards the poor in rural, semi urban or urban areas for enabling them to raise their income level and living standards in various countries. In developing countries like India the structure of economy is dualistic. The rich get richer and the poor get poorer. This worsens the access of poor to economic opportunities and reaches for formal financial services. Small enterprises in India suffer from a great deal of indebtedness and are subject to exploitation in the credit market through high interest rates and lack of convenient access to credit. They need credit to fund their working capital needs on a day-to-day basis as well as long term needs like emergencies or other income related activities. So the need for financial assistance and business development services for the micro and small enterprises is essential to alleviate poverty for consistent economic growth. The focus of the study is to find out whether these micro and small enterprises in and around Coimbatore city of Tamil Nadu were able to access Micro Finance Institutions (MFIs) for capital loans and services and utilize it for their growth and development.

Keywords: *Microfinance, Self Help Groups, NABARD,*

INTRODUCTION

Microfinance is financial services for poor and low-income clients offered by different types of service providers. In general, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as “microfinance institutions” (MFIs). Microfinance is very small loans to unsalaried borrowers, taking little or no collateral security. More over microfinance refers to a movement that envisions a world in which low-income people have permanent access to a range of high quality and affordable financial services offered by financial service providers. These services include savings, credit, insurance, remittances, and payments, and others. Microfinance is financial aid to economically disadvantaged segments of society and to enabling them to enhance their income levels. “The provision of financial services to low-income poor and very poor self-employed people” Otero (1999, p.8) “The attempt to improve access to small deposits and small loans for poor households neglected by banks" Schreiner and Colombet (2001, p.339).

Microfinance is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services. Micro finance is the provision of thrift, credit and other financial services and products of very small amounts to the poor for enabling them to raise their income levels and improve their living standards (RBI).Microfinance is a combined term used for monetary intermediation services to low income group and poor clients. Services offered are credit facility, saving accounts, money transfers, remittances, insurance and even investment. In general, microfinance deals with providing low income family with very small loans (micro-credit) to support them in order to engage them in productive activities. Perhaps the fundamental question for the motivational underpinnings of microfinance is whether it is a viable strategy for poverty alleviation relative to other poverty alleviation policies. Adams and von Pischke (1992). Amartya Sen writes, "While it is important to distinguish conceptually the notion of poverty as capability inadequacy from that of poverty as lowness of income, the two perspectives cannot but be related, since income is such an important means to capabilities.

Microfinance is not a new concept. It dates back in the 19th century when money lenders were informally performing the role of now formal financial institutions. Over the past two decades, various development approaches have been devised by policymakers, international development agencies, non-governmental organizations, and others aimed at poverty reduction in developing countries. One of these strategies, which have become increasingly popular since the early 1990s, involves microfinance schemes, which provide financial services in the form of savings and credit opportunities to the working poor.

CONCEPT OF MICROFINANCE

Microfinance enables the poor and excluded section of people in the society who do not have an access to formal banking to build assets, diversity livelihood options and increase income, and reduce their vulnerability to economic stress. In the past, it has been experienced that the provision for financial products and services to poor people by MFIs can be practicable and sustainable as MFIs can cover their full costs through adequate interest spreads and by operating efficiently and effectively. Microfinance is not a magic solution that will propel all of its clients out of poverty. But various impact studies have demonstrated that microfinance is really benefiting the poor households.

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses.

In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self-confidence and the training of members in that group on financial literacy and management. There are different providers of microfinance (MF) services and some of them are; NGOs, savings and loans cooperatives, credit unions, government banks, commercial banks or non-banking financial institutions. The target group of MFIs are self-employed low income entrepreneurs who are; traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers, artisans blacksmith etc.

EVOLUTION OF MICROFINANCE

Microfinance as an industry evolved in all the third world countries almost at the same time span. World over, it was getting widely recognized that improving income levels of low income community is essential to improve their well-being During the 1970s and 1980s, the microenterprise movement led to the emergence of Non- Governmental Organizations (NGOs) that provided small loans for

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the poor. One of the significant events that helped it gained prominence in the 1970s was through the efforts of Mohammad Yunus, a microfinance pioneer and founder of the Grameen Bank of Bangladesh. In 2006, Prof. Yunus was awarded Nobel Peace prize for his efforts to create economic and social development.

Microfinance in India started in the early 1980s with small efforts at forming informal

Self Help Groups (SHGs) to provide access to much-needed savings and credit services. From this small beginning, the microfinance sector has grown significantly in the past decades.

National bodies like the Small Industries Development Bank of India (SIDBI) and the National Bank for Agriculture and Rural Development (NABARD) are devoting significant time and financial resources to microfinance. The strength of the microfinance organizations (MFOs) in India is in the diversity of approaches and forms that have evolved over time.

REVIEW OF THE LITERATURE

Various aspects of microfinance and microenterprises have been discussed in the literature. Few empirical studies have quantified the impact of microfinance on poverty, some have focused on the relation between microfinance and socio-economic indicators, few concentrated on the sustainability and profitability, and few others estimated the return to capital invested in the micro enterprises (see Shirazi 2008). Microfinance surely bring some changes, which could be positive or negative on individuals, households and institutions (see Cheston et al,1999 and Baker, 2000). Some studies have been focused on the growth of income and expenditures of the borrowers due to microfinance. Hulme and Mosley (1996), for instance, based on the counter factual combined approach, analyzed the impact of microfinance on poverty alleviation using sample data for Indonesia, India, Bangladesh and Sri Lanka and found that growth of income of borrowers always exceeds that of control group and the increase was larger for better-off borrowers.

Manish Kumar (2010) “Micro-Finance as an Anti-Poverty Vaccine for Rural India” The potential for growing micro finance institutions in India is very high. Major cross-section can have benefit if this sector will grow in its fastest pace Annual growth rate of about 20 % during the next five year. The loan outstanding will consequently grow from the present level of about 1600 crores to about 42000 crores. Annual growth rate of about 20 % can be achieved during the next five years.

Sree Kumar (2012) ” Status of Microfinance in India - A Review” Government of India introduced Micro Finance Institutions (Development and Regulation) Bill 2012 on May 22, 2012 to establish a regulator under RBI to regulate and supervise the activities of NGOs and MFIs. The Bill requires all MFIs to obtain a certificate of registration from RBI. The RBI has the authority to set maximum annual percentage rate charged by MFIs and sets a maximum limit on the margin MFIs can make. Margin is defined as the difference between the lending rate and the cost of funds.

SIGNIFICANCE OF THE STUDY

To justify the importance of the current study, it is important to mention this area of study is very important for the development of socio economic activities in developing countries like India and its contribution to the development of micro and small enterprises. The study of this nature is essential to identify the role of MFIs products and services in small and microenterprises sector. This will enhance to identify MFI s and their contribution to the rural population in accessing to financial services in their localities to boost their living standards in a sustainable manner.

OBJECTIVES OF THE STUDY

The specific objectives of the study are to:

- To analyze the total capital invested by micro and small enterprises and to identify the contribution of financing through MFIs.
- To study the effective utilization of capital loans provided by MFIs to micro and small enterprises.
- To investigate whether capital loans and services of MFIs to micro and small enterprises lead to the growth and development of the organization.

METHODOLOGY & DATA SOURCES

The research work is based on descriptive and analytical research. The study is mainly based on secondary data. The relevant information in this regard is collected from various sources like annual reports of research units, other published book and journal related to study, commercial magazine. The reference books have been referred from libraries. Thus, various sources have used to collect the relevant data. The data has been collected from the annual report of NABARD.

MICROFINANCE MODEL IN INDIA

In India Micro financing Deals with four basic model and they are as follows

In first Model, it shows who borrows are and how they are facilitated. In these borrowers assisted directly by bank without intervention of any intermediaries like Non-government Organisation, In second Model, Borrowers are financed directly with facilitation extended by formal or informal agencies like Government, Commercial Banks and Micro-Finance Institutions (MFIs) like NGOs, Non-Bank Financial Intermediaries an Co-operative Societies.
In third Model, Financing takes place through NGOs and MFIs as facilitators a financing agency. In fourth Model, is the Grameen Bank Model.

Regulatory Framework for Microfinance Institutions in India

Sl. No.	Type of MFI	Legal Registration
1	Non-Government Organisations(NGOs)	Society Registration Act, 1860,Indian Trust Act, 1882
2	Non-Profit companies	Section-25 of Indian Companies Act, 1956
3	Mutual benefit MFIs – Mutually Aided Cooperative Societies (MACS)	Mutually Aided Co-operative societies, Act enacted by State Governments
4	Non-Banking Financial Companies (NBFCs)	Indian companies Act, 1956,Reserve Bank of India Act, 1934

EXISTING MICROFINANCE INSTITUTIONS IN INDIA

Indian Microfinance Institutions are predominantly NGOs i.e., nearly 80 % of the Microfinance Institutions operate under the Society/Trust form which is for the not-for-profit sector with a clear development agenda. Apart from this, other important legal forms are being used by Indian Microfinance Institutions. 10 % of organizations operate under the company structure; 5% are section 25 companies (Section 25 of the Indian Companies Act, 1956); 2% as Cooperatives; 2% as Non-Banking Finance Companies (NBFCs); and 1% as Local Area Banks.

a) Not for Profit Microfinance Institutions

a) NGO - Microfinance Institutions - 400 to 500 – Registered under Societies Registration Act, 1860 or similar provincial Acts Indian Trust Act, 1882
b) Non-profit Companies - 10 – Registered under Section 25 of the Companies Act, 1956

b) Mutual Benefit Microfinance Institutions

a) Mutually Aided Cooperative by State Government Societies (MACS) and similarly set up institutions -200 to 250 – Registered under Mutually Aided Cooperative Societies Act enacted by State Government

c) For Profit Microfinance Institutions

a) Non-Banking Financial Companies (NBFCs) - Registered under Indian Companies Act, 1956 Reserve Bank of India Act, 1934.

The major barrier to the development of Micro and Small Enterprises is access to credit. These enterprises differ in the level in which they are and the products and services offered to them by the MFIs. The micro and small enterprises need to be financed differently and the financing is determined by whether the firm is in the start-up phase or existing one and also whether it is stable, unstable, or growing. Stable survivors are those who benefit in having access to the financial services provided by MFIs to meet up with their production and consumption needs. Unstable survivors are groups that are considered not credit worthy for financial services to be provided in a sustainable way and Growth enterprises are Micro and Small Enterprises with high possibility to grow. In identifying the market, MFIs consider whether to focus on already existing entrepreneurs or on potential entrepreneurs seeking for funds to start up a business venture. Working capital is the main hindrance in the development of already existing SMEs and to meet up, the borrow finance mostly from informal financial services which have high interest rates and services offered by the formal sector or not offered by these informal financial services. In identifying the market, MFIs consider whether to focus on already existing entrepreneurs or on potential entrepreneurs seeking for funds to start up a business venture. Working capital is the main hindrance in the development of already existing SMEs and to meet up, the borrow finance mostly from informal financial services which have high interest rates and services offered by the formal sector or not offered by these informal financial services. The business activity of a microenterprise is equally as important as the level of business development. There are three main primary sector where an enterprise may be classified; production, agriculture and services. Each of these sectors has its own risk and financing needs that are specific to that sector.

SERVICES BY MICROFINANCE INSTITUTIONS

Products and services offered by microfinance institutions in and around Coimbatore for the development of Micro and Small Enterprises are basically classified as two i.e. Financial

Intermediation and Enterprise development services.

Financial intermediation: Providing financial assistance for small business groups in the form of business loans and those loans can be utilized for further investment in the existing business or setting up new tiny business ventures. Since the rate of interest and the repayment schedule are formulated to suit the requirements of the loan takers, there exist enormous demands for this product. MFI s extends such microloans ranging from Rs.5000/- to Rs.25,000/- for such income generating activities and few MFIs categorized their clients activities as farm based activities which includes Agriculture, Poultry, Sheep-rearing, Goat-rearing, sericulture, mushroom cultivation etc and non – farm based activities which includes Petty-shop, Catering, Provison shop, Tailoring, Embroidery work, Beauty shop Vegetable vendor, Fruit Vendor, Textile shop, Xerox machine, Brick making, Gold covering work, Jewellers work and others etc.,. The loans are taken by poor households directly as well as through groups to meet their diverse needs.

Enterprise development services: MFI s provides cost efficient microfinance coupled with knowledge and information services that raise human capacity and organizational capability and create open access to markets resulting in more productive loans. MFIs provide skill development services, business training, marketing and technology services to their clients based on their occupation which helps them use their resources more productively.

GROWTH OF MICRO AND SMALL ENTERPRISES

The term growth in this context can be defined as an increase in size or other objects that can be quantified or a process of changes or improvements. The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state (Penrose, 1995). The growth of a firm can be determined by supply of capital, labour and appropriate management and opportunities for investments that are profitable. The determining factor for a firm's growth is the availability of resources to the firm. MFI s considering the growth of Micro and Small enterprises developed large-scale operations by offering a few highly standardized products with few advantages like Streamlined loan administration, Simplified decision-making for field staffs, Reduced information requirements from clients, Low operational costs, Simplified repayment obligations. But this standardization also had its own disadvantages. So MFIs paid closer attention to product flexibility. Individual need-based loans are more suitable as they can be designed to cater to the specific requirements of the clients.

CONCLUSION & SUGGESTION

The demands for microenterprise loan products in India are increasing rapidly but empirical research on the impact of such products is still lacking. Therefore, this study took initiative to empirically measure the impact of microenterprise loan on entrepreneurship development.

Major findings showed that loan products in India are contributing toward increased income but are yet to do many things to enhance innovation. It was generally thought that MFIs applying group lending techniques are not only providing financial capital but also social capital in the form of membership, network, and social mobility among clients, and such social networks are broadening the scope for increased income and innovation. But this view was supported only in the case of income and not for innovation. Micro entrepreneurs having long-term membership with MFIs were able to enhance their income. The lending group did not have any significant relations with either income or innovation. Moreover, innovation, although, not significant, showed a negative relation with the lending group. This supported that loans provided by the MFIs in India are expanding the scope for micro entrepreneurs to increase income through replicating a similar business model, which is not conducive to sustainable business growth because evidence shows that similar businesses in the same industry produce diminishing returns to income.

Further that micro entrepreneur not only has financial obstacles but also they lack many business skills and knowledge regarding market, technologies, and other information required for the sustainable development of their businesses. Therefore, MFIs have to develop their capacities to either facilitate the micro entrepreneurs to have some business support services or provide information to avail necessary business skills, training, and market information by the clients. This is essentially due to the fact that financial capital alone may not help the micro entrepreneurs to fight against various obstacles and challenges. Based on the findings, two major policy implications could be recommended for sustainable microfinance and microenterprise development in India. First, entrepreneurial training including basic business skills, opportunity identification, and product positioning and product differentiation in the market should be considered either through direct providing or through facilitating. These micro entrepreneurs in order to organize these unorganized sectors to enhance sustainable entrepreneurship and economic growth.

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