SOUTH INDIAN Bank

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Theme 212
MICRO FINANCE
PART II

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Theme No. 212 : MICRO FINANCE - PART II

What is a Micro-Finance Institution/Organisation?

Micro Finance Institutions (MFIs) perform a significant role in facilitating access to financial services, with focus on credit, to socially and economically poor households. MFIs are expected to improve the standard of living in India where around 70 million households are poor. MFIs are uniquely positioned for reaching out to the poor. Many of them operate in a limited geographical area, have better understanding of the issues specific to the poor, enjoy greater acceptability amongst the poor and have flexibility in operations, providing a level of comfort to their clientele.

The origin of several Indian MFIs can be attributed to reluctance of banks to meet the needs of the poor. In such situations, NGOs get into action by opening a microfinance division or by setting up a separate MFI. An increasing number of microfinance institutions are seeking non-banking financial company (NBFC) status from RBI to get wide access to funding. NBFC status will also bring credibility and allow them to be regulated by RBI, making them more accountable. In the last couple of months, RBI has granted fresh NBFC licenses to MFIs such as Grameen Koota in Bangalore, Bandhan in West Bengal, Opportunity International in Chennai, Ujivan in Bangalore, Biswa in the East etc.

Internationally there are two types of funds for microfinancing.

i) Commercial funds which seek a financial return.
ii) Non-commercial funds that do not seek financial return.

Non-commercial funds are established by public and/or private participants with the aim of, either solely or partially, promoting microfinance.

What are the limitations of MFIs in India?

The micro finance institutions in India suffer from inadequacy of funds and incapability to bear and manage risks. While MFIs have reduced their own lending risks through group guarantees and addressed the issue of willful default, they have not been able to grapple with the situation where the underlying economic activity fails and the borrower faces a genuine problem. This can be tackled with a combination of savings and risk mitigation products.

Beyond a certain level, MFIs have to seek external funds for keeping the credit activity going. When MFIs seek funds from financial institutions, issues like ownership structure and capital adequacy become critical. For MFI to survive in the long run, it has to transform itself into an institution with transparent systems and accountability. In most cases, the promoters of MFIs do not have sufficient capital to invest and therefore the main constraint is that they are dealing with other people's money. NGOs have no clear cut ownership structure, and making the people liable under this format is difficult. If NGOs are to be sustainable, they have to link with mainstream institutions like commercial banks.

MFIs can raise resources by issuance of debt securities. Earlier only a few commercial banks took interest in the non-convertible debentures (NCDs) issued by MFIs. Now insurance and mutual fund houses and FIIs are also interested in the NCDs of MFIs. Recently, Hyderabad based SKS Microfinance and Spandana raised Rs.75 crore and Rs.80 crore respectively through NCDs which were placed with Standard Chartered, after being listed on the stock exchange. Kolkata based Bandhan, Share Microfinance etc. plan to raise funds through NCDs. SKS Microfinance raised Rs.25 crores through commercial paper. In the past, MFIs relied upon bank loans and securitisation, whereby they sell a pool of microfinance assets to a bank at a discounted rate.

What are the comparative advantages of Indian MFIs?

A comparative study of the performance of Indian MFIs with that of other MFIs around the globe revealed that MFIs in India were cost effective, efficient, productive, and were managing risks well. Indian MFIs paid considerable attention to developing human resource management and training policy as well as selection of geographical area for establishing offices. The staff of MFIs were by and large from local area, adequately qualified having affinity to serve rural areas, trained, and periodically exposed to real field situation through cross country exposure for learning and sharing experiences (study tours, seminars, workshops, conferences, etc.). Loan policy focusing on proper identification and selection of eligible borrowers, pre-sanction appraisal of client and credit proposal, post disbursement supervision and follow-up on the end use of credit till it is fully repaid were adequately implemented. MFIs were able to project better image that enabled them to establish credibility to borrow sizeable funds for on-lending.

What is the role of RBI in promoting microfinance?

The RBI in its Annual Policy Statement for the year 2005-06, urged all the banks in the country to review their existing practices to align them with the objective of financial inclusion. RBI's intention is to bring all the rural households under banking fold.

With a view to enabling banks to increasingly involve in the area of rural banking during 11th Five Year Plan, the Government and the RBI have further committed to new innovations, such as i) establishing financial literacy/credit counselling centres, (ii) technology adoptions, iii) establishing Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF), and iv) establishing Microfinance Development and Equity Fund (MFDEF).

What are the contributions of NABARD in promoting microfinance in India?

The SHG-Bank linkage programme of NABARD has emerged as the primary model for providing Micro Finance services in the country. It is a proven tool for extending access to formal financial services to the unbanked rural clientele. Encouraged by the success of the programme, NABARD promoted the linkage of MFIs with the banking sector and the following initiatives are taken for promotion of micro finance.

1. Support to Partner agencies: NABARD by way of financial assistance continued to support NGOs, RRBs, DCCBs, Farmers' Clubs and Individual Rural Volunteers (IRVs) for promoting and nurturing of quality SHGs. It continued to direct its efforts towards roping in the services of new Self-Help Promoting Institutions (SHPIs) while continuing to support the existing ones.

2. Capacity Building of Partner Agencies: NABARD continued to play the role of a facilitator in scaling-up the micro-finance programme. Various training programmes are conducted for SHG/NGO/Bank officials.

3. Micro-enterprise promotion by SHGs: NABARD had launched the micro-enterprise development programme (MEDP) on skill upgradation and development for sustainable livelihoods for members of matured SHGs. Marketing support is provided by arranging exhibitions.

4. Support to Micro-Finance Institutions: Recognizing the role played by MFIs, in extending micro-finance services in the unbanked areas, NABARD extends support to these institutions through grants and loan based assistance.

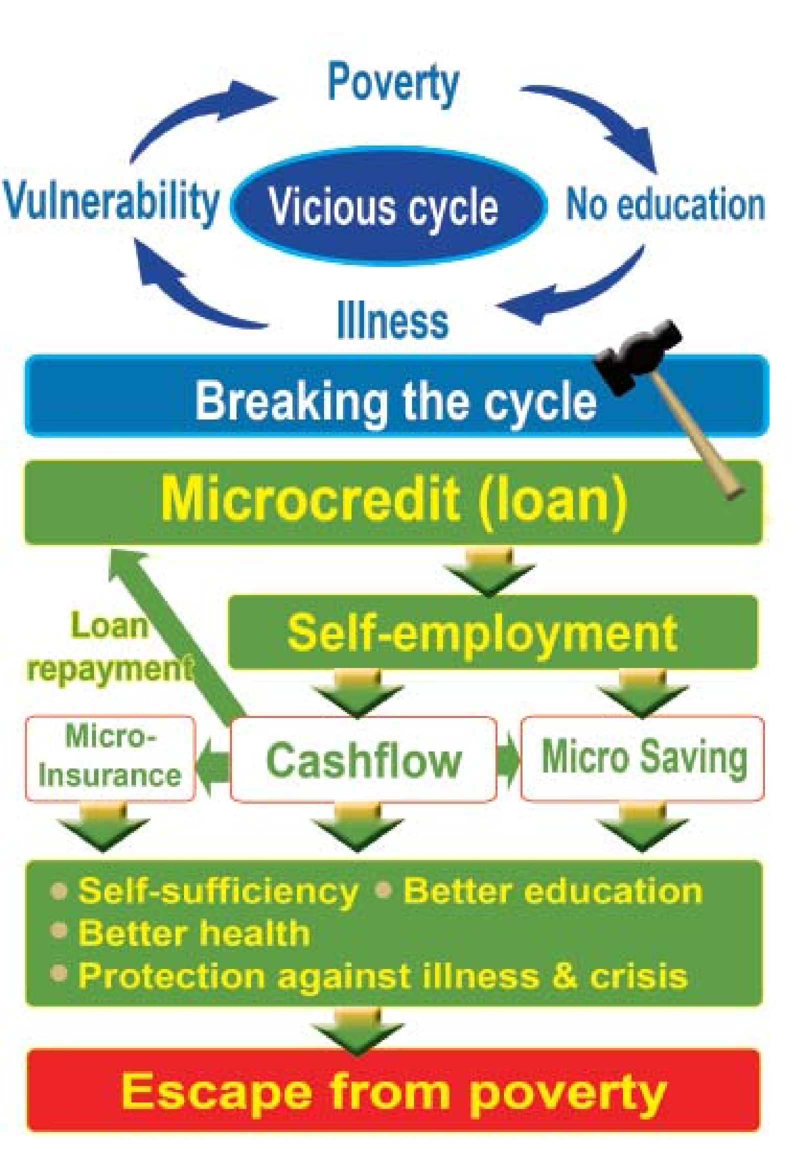
5. Research and Development Activities: Research and Development (R & D) Fund was set up since inception by NABARD to provide financial support for conducting in-depth studies, promoting applied research and technology based innovations. It also aimed at training and skill upgradation of personnel of client institutions and dissemination of research findings.

What is the impact of global economic slowdown on microfinance industry?

Microfinance could face a fall in growth and funding because of the global recession and declining invester confidence. It was confirmed by a recent survey, sponsored by Citi Foundation and the Consultative Group to Assist the Poor (CGAP) and supported by the Council of Microfinance Equity Funds (CMEF). The survey was designed to identify and rank the main risks facing the industry at a time of economic crisis and change. The major risks are found to be a surge in bad loans, shortage of liquidity and funding, declining profitability, and weakness in management and corporate governance. There is also the risk that some MFIs may eventually fail.

Conclusion

Microfinance initiatives have shown that banking with the poor is a viable proposition. Micro-credit has been hailed as the best method of creating additional employment and removing poverty. NABARD has been playing a catalytic role in terms of promotional support to NGOs and also in nurturing quality SHGs. Successful marketing of micro-finance to SHGs will further strengthen the movement. Linking of SHGs with banks plays a vital role for women development. It is expected that with assistance though micro-finance, all the rural/urban poor households can be raised above the poverty line. Though the services offered by MFIs and SHGs are micro in nature, the total benefits will have impact at macro level.



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