A Comprehensive Study on the Effects of Microfinance Institutions' Activities on Economic Growth of India:

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ABSTRACT:
India has supported social banking for a long time. Policy directions to rapidly expand rural branches, mandate credit allocations for priority sectors (including agriculture), deliver large subsidy oriented credit programmes to serve marginal communities and poor households and control interest rates have been tried for over 35 years. For these purposes, microfinance industry is set to reach new heights. With superlative growth numbers in a period of economic downturn, the sector has come to attention of a wider range of investors. The rapid growth of the microfinance sector in the last few years has completely changed its complexion and nature. The growth has transformed microfinance: from being a sub-set of the development sector it has become a sub-set of the financial services industry. In the last two years competition amongst microfinance institutions (MFIs) as well as with the Self Help Group (SHG) movement has emerged India. This paper discusses the role of microfinance industry in country‟s economic growth in terms of its GDP. It also discusses the changed scenario in the competitive environment and the issues in microfinance institutions. Karl Pearson‟s coefficient of correlation is used to determine the role of microfinance in country‟s growth, which state a very high correlation between these two.

KEYWORDS: Microfinance Industry, Gross Loan Portfolios, Total Borrowings, NBFCs, GDP.

INTRODUCTION:

Definition of a Microfinance Loan:

The RBI revised the definition of a microfinance loan to indicate a collateral-free loan given to a household having annual income of up to Rs. 3 lakh.
Earlier, the upper limits were Rs.1.2 lakh for rural borrowers and Rs.2 lakhs for urban borrowers.
(Given by: RBI)

Concept of Microfinance:

Microfinance is a collective term used for financial intermediation services to low income groups and poor customers. Services offered are credit facility, savings accounts, money transfers, remittances, insurance and investments.
Microfinance and microcredit are used interchangeably but are, in fact, quite distinct. Microfinance is a much broader concept than microcredit and refers to loans, savings, insurance, money transfers, and other

financial products targeted at poor and low-income people. Microcredit refers more specifically to making small loans available to poor people, especially those traditionally excluded from financial services, through programmes designed specifically to meet their particular needs and circumstances.
A Microfinance Institution (MFI) is an organization that provides financial services targeted to the poor. While every MFI is different, all share the common characteristic of providing financial services to a clientele poorer and more vulnerable than traditional bank clients.

Basic Principles of Micro Finance Organizations:

- Poor sections of the society need a variety of financial services, not just loans. They need a wide range of financial services that are convenient, flexible, and reasonably priced. They need not only credit, but also savings, cash transfers, and insurance.
- Microfinance is a powerful instrument against poverty. Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, health and education.
- Microfinance means building financial systems that serve the poor. In India, substantial section of our population is poor. Yet, many lack access to basic financial services. Microfinance should become an integral part of the financial sector.
- Financial sustainability is necessary for poor people. Many are not able to access financial services because of the lack of strong retail financial intermediaries. Building financially sustainable institutions is the only way to reach significant scale and impact. Micro finance service provider, a bank in this context, should be able to cover its costs and continue to serve the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the unbanked poor.
- Microfinance is about building permanent local financial institutions. Building financial systems for the poor means building sound domestic financial intermediaries that can provide financial services to poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services.
- Microcredit, a critical part of micro finance, is not always the answer. Microcredit is not appropriate for everyone or every situation. In many cases, small loans, employment and training programs, and other non-financial services may be more appropriate tools for poverty alleviation. Wherever, possible, such non-financial services should go hand in hand with building savings of the poor.
- High Interest rate ceilings reduce access to financial services. For a bank, it costs much more to make many small loans than a few large loans. Unless bankers can charge interest rates that are above average bank loan rates, they cannot cover their costs. They may not be able to sustain themselves. At the same time, banks should not pass on operational inefficiencies to clients in the form of high interest rates and other charges.
- The government's role is as an intermediary, not as a direct provider of financial services. It should stimulate development of microfinance ecosystem while assuring safety of savings made by the poor. Where required, government funding for microfinance institutions is required when other funds are lacking.
- The lack of institutions is a major limitation. Microfinance is a specialized field that combines banking with social goals. Capacity needs to be built at all levels, from financial institutions through the

regulatory and supervisory bodies and information systems, to government agencies. Most investments in the sector, both public and private, should focus on this capacity building.
- It is important to have financial and outreach transparency. Accurate, standardized, and comparable information on the financial and social performance of financial institutions providing services to the poor is vital to take corrective measures regularly. Bank supervisors and regulators, investors, and more importantly, the poor who are clients of microfinance need this information to adequately assess risk and returns.

Based on the basic principles of Micro Finance Institutions discussed above, the key characteristics may be summed up as follows:
- They lend to the poor.
- No security is taken from the borrowers
- MFIs prefer saving over borrowing
- They provide small short term loans
- Interest rates charged on the loans are regulated by RBI.
- Group formation, appraisal and guarantee are the pillars of MF lending.
- MFIs encourage women customers to men.

MICROFINANCE MODELS AND CHARACTERISTICS:
Microfinance activities take place in several ways and they are through:
- Individual and group, Community Banking, ROSCA
- Cooperative, Intermediaries, NGOs.
- Grameen Banks
- Bank Partnership model through bank guarantees or on the basis of peer pressure.

Several micro finance models are functioning in India. Any model is a collaboration of two or more of the parties are involved.

1. Self Help Group (SHG) Model: This is the most popular model in India and is commonly known as SHG-bank linkage program (SBLP). It is estimated that close to 75% of micro finance funding in India takes place through SHG-bank linkage.
- **SHG MODEL -I:** SHG formed and financed by banks, where the banks involved play dual role of promotion of SHGs and also provider of credit to SHGs.
- **SHG Model- II:** SHGs formed by formal agencies other than banks (NGOs and other) but directly financed by banks where the NGOs and other agencies have played the role of facilitator.
- **SHG Model- III:** SHGs financed by banks using NGOs and other agencies as financial intermediaries where the NGOs and other agencies play the role of financial intermediaries. The exact process of commercial bank linkages to micro finance will be taken up later in this module. The general characteristics of this model will be discussed here.

Members from a poor or underprivileged society form a group of around 20 members. The group formation may be facilitated by an NGO or a Micro Finance Institution (MFI) or bank itself or by themselves with guidance from a leader of their group. The group may also evolve from a traditional rotating savings and credit group (ROSCA) or any other locally initiated grouping. The key features are:

- Small group of poor (10-20 ideally) preferably women
- Similar socio-economic background
- United for a common cause
- No need for registration
- Group functioning and discipline need to be maintained
- Activities may be savings/borrowings/lendings
- May be started by a teacher, retired employee, educated but unemployed youth, NGO, farmers' club of the area, banker etc.
- Reduces transaction costs for both lenders and borrowers
- Regular meetings and peer pressure for repayment of amounts borrowed by any member

2. Grameen Model:

The Grameen Model emerged from the poor-focused grassroots institution, Grameen Bank, started by ***Prof. Mohammed Yunus*** in Bangladesh. As an exemplary model it is now applied in many countries of the world. Grameen Bank Model is based on the voluntary formation of small groups of five people to provide mutual, morally binding group guarantees in lieu of the collateral required by conventional banks. A Slight variation of this model is that a bank unit is set up with around 10 to 20 villages with a manager and field staff. The manager and staff start by visiting villages to familiarise themselves with the local society in which they will be operating and identity prospective clients, as well as explain the purpose, functions, and mode of operation of the bank to the local population. It is also called the village Banking Model.

The key Features are:

- Regular weekly or monthly meetings and records of savings, borrowings and repayments are maintained. This is generally supervised by MFI worker or bank.
- The local contact in each group collects savings and repayments and hands over the amounts to the supervisor/manager of the bank which lends money to a member of the group.
- Loans to individual members of the group have joint and several liability-essentially loans given to one member is guaranteed jointly by the other members. Members can raise group emergency funds. If any member of the group defaults in repayment, no member can take loans.
- Peer pressure ensures repayment of loans so that the default by one does not compromise the borrowing facility of the other members in the group.
- It is the group responsibility to apprise loan applications, take care that members of the group maintain regular savings and proper loan repayments are made according to the schedule.
- Essentially, group dynamics play an essential role in maintaining group discipline. So also every member of the group can benefit by taking loan as required provided he/she saves regularly.

3. Joint Liability Group (JLG) Model:

JLG is an informal group comprising 5 to 10 members who come together for the purpose of availing bank loans either individually or through the group against a mutual guarantee.

4. Cooperative Model:

It is also called Credit Union Model and has been initiated by Cooperative Development Forum, Hydera-

bad which has relied upon a 'credit union' involving the saving first strategy. It has built up a network of Women Thrift Groups and Men Thrift Groups. They are registered under Mutually Aided Cooperated Society Act and mobilize savings resources from the members and access outside/supplementary resources from the individual system.

5. Partnership Model:

The Partnership Model has been adopted by certain private sector banks. In this model, the bank ties up with an MFI, who as an agent of the bank manages MFI Portfolio which is funded by the bank. MFI collect a service charge from the borrowers to cover its transaction costs and margins.

Micro Financing by Commercial Banks:

Commercial Banks are bound by the Priority Sector Lending targets. The business strategies normally adopted by Commercial Bank to counter inherent risks in Micro Finance lending are:

Adopting Partnership Model:

as discussed earlier in this module. Here, MFIs identify, train and promote MF clients. Banks finance directly to MFIs or to clients based on the recommendations of MFI. Customer portfolio is shared by MFI and resides in bank books.

Securitisation of Portfolios:

Securitisation has become an important aspect for bankers of late. Banks buy out portfolios from MFIs. While MFIs continue to service clients and act as collection agents, they act as intermediaries and facilitators. They share credit risk with the bank and hence are particular about the credentials of borrowers.

Leveraging Technology Support:

Banks have adopted Core Banking Systems and use it to manage loan portfolio generated under the Partnership Model.

Form Links with NGOs:

Banks branches at regional and local level liaise with NGOs to reach their lending targets to Micro Finance Units.

Set up systems to support their lending activities:

Banks involve in mentoring clients specifically in areas of credit discipline and able governance to the leading person or organization. This system extends to loan portfolio evaluation too, essentially done by the partnering agency of the banks.

Lending to MFIs and NGOs:

This is also a popular mode of lending where the banks follow a wholesale linkage model. Banks bulk lend to MFIs who in turn, lend to poor specifically women.

Limitations Faced by Commercial Banks:

Banks face some Limitations, which deters lending to micro finance institutions or SHGs, directly or indirectly. The limitations are due to:

- High transaction costs
- Credit risk
- High dependence on monsoons-most borrowers are rural
- Uncertainty of market conditions
- Lack of skills of those involved in the process, other than banks

- Lack of authenticity in assessing income of borrowers
- Operational risks- specifically business promotion
- Literacy, skill and attitude levels of clients
- Diversion of funds to unproductive activities

Role of Reserve Bank of India (RBI) and NABARD:

Special mention must be made of the role played by the Central Bank-RBI and regulator which is NABARD.

Role of RBI:

- RBI has supported financial liberalisation and has created conditions for the sector to sustain itself.
- Involves in regulation and supervision of all players in the MF sector.
- RBI has supported pilot MF projects over a number of years
- RBI engages in regularly collecting data, analysis and publication of the collected data.
- RBI involves itself and other partners in training and advocacy.

Role of NABARD:

- NABARD involves itself continuously in framing policy and guidelines for rural financial institutions involved in Micro Financing activities.
- Provides credit facilities to organizations involved in micro financing.
- Prepares potential linked credit plans annually to identify credit potential.
- Monitors ground level flow of rural credit to MFIs.

ECONOMIC GROWTH:

Concept:

Economic growth can be defined as an increase in the value of goods and services produced in an economy over a period of time. This value calculation is done in terms of % increase in GDP or Gross Domestic Product.

Economic growth is an increase in the production of economic goods and services in one period of time compared with a previous period. It can be measured in nominal or real (adjusted to remove inflation) terms. Traditionally, aggregate economic growth is measured in terms of gross national product (GNP) or gross domestic product (GDP), although alternative metrics are sometimes used.

GDP growth surprised coming in significantly **highe**r than expected for the **fourth quarter**, taking the full-year number to **7.2 per cent in 2022-23.** Growth was led by higher-than-expected agriculture growth and strong growth in services. Almost 70 per cent of the growth increase came from the services sector alone.

Strong economic growth in the first quarter of FY 2022-23 helped India overcome the UK to become the fifth-largest economy after it recovered from repeated waves of COVID-19 pandemic shock. Real GDP in the first quarter of 2022–23 is currently about 4% higher than its corresponding 2019-20, indicating a strong start for India's recovery from the pandemic. Given the release of pent-up demand and the widespread vaccination coverage, the contact-intensive services sector will probably be the main driver of development in 2022–2023. Rising employment and substantially increasing private consumption, supported by rising consumer sentiment, will support GDP growth in the coming months.

Future capital spending of the government in the economy is expected to be supported by factors such as

tax buoyancy, the streamlined tax system with low rates, a thorough assessment and rationalisation of the tariff structure, and the digitization of tax filing. In the medium run, increased capital spending on infrastructure and asset-building projects is set to increase growth multipliers, and with the revival in monsoon and the Kharif sowing, agriculture is also picking up momentum. The contact-based services sector has largely demonstrated promise to boost growth by unleashing the pent-up demand over the period of April-September 2022. The sector's success is being captured by a number of HFIs (High-Frequency Indicators) that are performing well, indicating the beginnings of a comeback.
India has emerged as the fastest-growing major economy in the world and is expected to be one of the top three economic powers in the world over the next 10-15 years, backed by its robust democracy and strong partnerships.

EFFECT OF MICROFINANCE INSTITUTIONS' ACTIVITIES ON ECONOMIC GROWTH OF INDIA:
Microfinance institutions (MFIs) came into being in the 90s as banks' reluctance to lend to those without credit history provided an opportunity to those willing to take the risk and organize rural communities. **Poverty alleviation:** Microfinance disrupts the cycle of poverty by making more money available.

RBI'S NEW GUIDELINES TO MAKE MICROFINANCE STRONGER:
The Reserve Bank of India (RBI) recently released its final guidelines for microfinance institutions (MFIs) that will be applicable to all entities (banks, small finance banks and NBFCs) engaged in this sector. Unlike the earlier definition that distinguished between rural and urban, RBI has now set a common household limit of Rs 300,000 for loans to qualify as microfinance. For entities to qualify for an NBFC-MFI licence, they should have at least 75% of assets in microfinance and the cap on NBFCs was increased to 25% of assets as against 10% earlier.
Besides, maximum possible indebtedness per borrower was increased to Rs 240,000 (from half of that earlier) and, most importantly, the 10% spread cap that was applicable to NFBC-MFIs has also been doneawaywith.
The guidelines are positive for NBFC-MFIs, especially because it levels the playing field for them (hitherto the 10% spread cap was applicable only to NBFC-MFIs) and it allows the board to create a policy that prices the credit risk adequately. Increasing the household income threshold to Rs 300,000 will also expand the addressable market for MFI players.
The listed shares of the MFI players (NBFC-MFIs, banks and SFBs) in India have been under tremendous pressure since the onset of Covid, down between 12% and 75%. Strange as it may sound, this does not come as a surprise.MFI players in India are habituated to managing interim stress from natural disasters, social unrest, political interference and pandemics.
Let us look at the history before I conclude how resilient these businesses have become, and a turnaround could be around the corner.
MFIs, as we know it today, was pioneered by Muhammad Yunus' Grameen Bank in Bangladesh (in 1976), who was later awarded a Nobel Peace Prize. In India, we can trace the roots of MFIs back to SEWA (a co-operative bank in 1974) and NABARD in 1982.
However, the first modern MFI in India can be linked to Vikram Akula (when he founded SKS Microfinance in 1997, later renamed as Bharat Financial Inclusion, and then merged it with IndusInd bank) and to Chandra Shekhar Ghosh, who created Bandhan a ..

MFIs went on to create a niche for themselves, addressing a social cause that the public sector banks were expected to but could not, while continuing to generate huge returns. Things were chugging along well until an issue erupted in 2010 (SKS would report revenues of over Rs 10 billion in FY11). In Andhra Pradesh, scores of MFI borrowers committed suicide reportedly unable to face strong-arm collection tactics.
SKS had just listed on the bourses, and everyone now knew how profitable the business was (over 4% ROA, and over 20% ROE).
After the AP incident, the rules were altered dramatically (specify area of operation, limit spreads, recovery tactics, state government approval, a bill passed in Parliament, credit bureaus set up, and so on). In 2012, SKS would recognise bad debts that were twice its cumulative pre-tax profits of 2005-11). Industry recovered from that shock and started expanding again until demonetisation in 2016 when gross non-performing ratios (GNPAs).
spiked up again (almost equivalent to the AP crisis levels). The MFI industry eventually recovered from that as well and faced many more natural disasters until it hit a wall again in 2020 and saw successive rounds of Covid lockdowns.
However, for the first time since 2020, disbursements by microfinance lenders in 2Q22 were higher than pre-Covid level, collection efficiency (excluding arrears) reached 96-98% by February 2022 (improving even in laggard states of Karnataka, Maharashtra, Tamil Nadu Madhya Pradesh, West Bengal and Assam), portfolio at risk was off materially (still elevated at around 5-6% versus the norm of 1-2%, but way off from highs of 25-30% seen in June 2021) and repayment of dues has started in earnest (Bandhan disclosed that two-thirds of its NPA and restructured accounts were paying their dues in full or part).
MFI in India is a super-cyclical business and will face challenges every few years for some reason or the other. While one needs to be vigilant, the cyclicality creates a decent opportunity. If collections hold, MFIs will start focusing on growth again, and there is a big untapped opportunity still awaiting.
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Given that MFI stocks have corrected decently from their respective tops, they would fit the bill of “not great companies, but a good investment at this juncture”.

LITERATURE REVIEW:

Table:1 Bibliographic Analysis Articles on Microfinance:

	Design/Technique of study	**Findings**
1. Bhoj & Kumar (2013)	Qualitative; personal interview method, Logit model.	Women participation in SHGs increased with increase in age & education level. Significant contribution of SHGs towards women empowerment by financially, socially culturally upliftment.

2. Krenj (2014)	Exploratory research “Credit Plus” model Interview method.	Empowerment lead to socio-emotional well-being, gain in assets, improvement in household gender equity.
3. Mula & Sarker (2013)	Regression & Paired t-test, Impact index analysis	Empowerment lead to economic & social upliftment, improved self-value, wider access to diversified livelihood strategies.
4. Kalpana (2016)	Ethnographic	Low access bank loans women’s face challenges such as betrayal, in sensitivity to multiple demands. Irritable bank managers who struggled to operate understaffed rural branches.
5. Swain & Wallentin (2017)	Structural equation model, Quasi-experimental design	Economic factors have a significant impact in empowering women in the southern states of india. For other states, autonomy in women’s decision-making & network, communication & political participation shows significant correlation. Regional imbalance in favour of southern states.
6. Sehu (2015)	Qualitative; Exploratory	The length of membership in SHGs increases the intensity of women’s economic & political empowerment. “Economic empowerment” may not lead to the attainment of social &/or political empowerment.
7. Laha & Kuri (2014)	Linear Regression	Southern states perform relatively better in economic & financial empowerment of women. Southern region is leading in the outreach of microfinance programme, followed by central, northern, north eastern & eastern regions.

8. Madar (2014)		It has drawn on normative & ideological shifts that present finance as a means of positive social ends. Microfinance as a tool for market-building.

Source:
https://www.researchgate.net/publication/366604522_Role_of_Microfinance_in_India_A_Thematic_Review_The_Microfinance_Review_141_2022

RESEARCH METHODOLGY:

1. The period of study is **2018-2019**.
2. In this, there is "**Descriptive & Empirical research**". There is used **"Secondary data"** for conducting research. As an investigator, get this data from text books, journals, articles, published or unpublished, websites, e-journals. There is used **"Judgmental Sampling"** technique (Non-Probability) for doing research. The sample size is **"2",** I have taken data of "2 years". There is dependent variable **"Economic Growth of India"** and Independent variable **"Microfinance Institutions"**. Here, there will be considered **"Simple Hypothesis"** in conducting research.

- **Null Hypothesis, H0:** There is no relationship between Economic Growth of India and Microfinance Institutions.
- **Alternate Hypothesis, Ha:** There is relationship between Economic Growth of India and Microfinance Institutions. It means Economic Growth of India depends on Microfinance Institutions.

To Test the relationship between dependent variable and independent variable i.e., Economic Growth of India and Microfinance Institutions.

TYPES OF STATISTICS:

1. Descriptive Statistics
2. Inferential Statistics

DATA ANALYSIS AND INTERPRETATIONS:

1. DESCRIPTIVE STATISTICS:

Contribution of microfinance to national economy

Over the last two decades, India has been on a steady path of growth with the Gross Domestic Product (GDP) growing by more than 5 times and the per capita income doubling. But the challenge of reducing the uneven distribution of income has been a constant for the policymakers. The trickledown of the benefits of economic growth to the strata at the bottom of the economic ladder has been less than satisfactory. Direct transfer of benefits as a method of redistribution of economic gains faces resource constraints in a developing economy like India. In this scenario, microfinance has been offered as an important 14 India Microfinance Review FY 2021-22 Table 1.2: Contribution to (GVA), 2018-19 Table 1.3: Contribution to Employment (Lakh jobs, 2018-19) Contribution of the direct and indirect backward linkage of the NBFC-MFI sector 0.08% The impact due to the 'forward linkages' 0.53% Total direct, indirect backward and forward linkages 0.61% The contribution of microfinance sector as a whole, including all MFIs and SHGs 2.03% Impact through the direct and indirect backward linkage of the NBFC-MFI sector on employment 1.20 The impact due to the 'forward linkages' 37.34 Total direct,

indirect backward and forward linkages 38.54 The contribution of microfinance sector as a whole, inclusive of direct, indirect backward and forward linkages and including all MFIs and SHGs 128.46 mechanism of 'direct intervention' to help the poor improve their economic condition. In the face of competing priorities in front of the policy makers and to ensure that microfinance can demand its due share of attention, it is important to evaluate microfinance in terms of its contribution to the two main policy goals: increasing GDP and generating employment opportunities.

Several microeconomic studies have investigated the positive impact of microfinance on the borrowing household's health, education, income generation and consumption, on women's empowerment, and other non-economic benefits, namely, conflict resolution and social and political reconciliation. However, there is an absence of any macroeconomic study quantifying the contribution of microfinance to the Indian economy. To address this vital gap, MFIN commissioned a research project by National Council of Applied Economic Research (NCAER). The study was a pioneering attempt to estimate the contribution of microfinance to the GDP and employment in India. The study titled 'Present and Potential Contribution of Microfinance to India's Economy'* had two main objectives:

- Measure the contribution of the microfinance sector to the overall economy in terms of income or 'Gross Value Added' (GVA), and
- Assess the impact of microfinance on employment generation The study estimated contributions of the microfinance sector to the macro economy in 2018-19 to be 2.03% of the GVA while generating nearly 1.3 Cr jobs, as shown in Table 1.1 and 1.2.

Table 1.1: Contribution to (GVA), 2018-2019

Contribution of the direct & indirect backward linkage of the NBFC-MFI Sector	0.08%
The impact due to the "forward linkages".	0.53%
Total direct, indirect backward & forward linkages	0.61%
The contribution of microfinance sector as a whole, including all MFIs & SHGs	2.03%

Table 1.2: Contribution to Employment (Lakh jobs, 2018-19)

Impact through the direct & indirect backward linkage of the NBFC-MFI sector On employment	1.20
The impact due to the "forward linkages."	37.34
Total direct, indirect backward & forward linkages	38.54
The contribution of microfinance sector as a whole inclusive of direct, indirect Backward & forward linkages & including all MFIs & SHGs	128.46

*Source: *https://www.ncaer.org/publication_details.php?pID=402*

INTERPRETATION:

These numbers are significant. The financial sector as a whole, including insurance, of which microfinance is a part, accounted for 5.5 per cent of GVA in 2018-19. While the microfinance delivery system is relatively small even within the formal financial sector of the economy, the important effects of microfinance include its forward linkages: the households and enterprises that use credit to add value through their own production processes. When we consider the 'forward linkages' of the sector, which in turn, generate value addition and jobs, the significance of the microfinance sector in the economy is more appropriately captured.

RESEARCH OBJECTIVES AND IMPORTANCE:

This paper attempt to analyse:

a. the trend of the microfinance industry,
b. relationship between microfinance industry and the economic growth of the country,
c. the issues in microfinance sector,
d. the changed scenario of microfinance institution under competitive environment &
e. the future of microfinance industry

CONCLUSION:

After the pioneering efforts of the last ten years, the microfinance scene in India has reached a take-off point. As a sum, the role of microfinance in India cannot be understated. Although, in the competitive scenario the industry is converting into for –profit NBFCs from not- for profit NGOs and has forgotten its primary role to address the needs of poor in country, but, the role of microfinance whether in „for-profit" or„ not-for-profit" formats will remain. Because the government and its programs only cannot fulfil the needs of poor. Adopting a client-responsive approach, coupled with ethics-based transparency, could take this sector to greater heights and fulfil a very strong need of poor people in India.

FINDINGS:

The sector continues to see many not for profit MFIs transforming to become for profit Non-Bank Financial Corporation's (NBFCs). This move has been driven by the need to raise additional debt (which is readily available from commercial banks seeking to meet their priority sector lending requirements) and, in some cases, the increased size and profile of the financial service sector and micro finance sector in particular has also stimulated the Reserve Bank of India (RBI) into action. In the midst of global liquidity crisis in 2008, the RBI increased the CAR - the ratio of capital to risk weighted assets - for NBFCs MFIs from 10% to 12% by March 2009. This requirement is expected to grow to 15%, and other measures may be looming as RBI and the Ministry of Finance display increasing discomfort with the direction the microfinance industry is taking. In a competitive environment, microfinance institutions must shift their thinking to respond to different challenges

THE ISSUES OF MICROFINANCE INDUSTRY:

The rapid growth of the microfinance sector in the last few years has completely changed its complexion and nature. The growth has transformed microfinance: from being a sub-set of the development sector it has become a sub-set of the financial services industry. This growth has led to many issues and challenges before the sector and one of the major concerns voiced about the sector has been that of „mission drift". Various issues have been brought out to highlight the problems in the microfinance sector and the main concerns are as follows: Borrower Unfriendly Products and Procedures with a majority of the customers being illiterate, and a majority of them needing consumption loans and a majority of them requiring high documentation and collateral security, the products are not reaching the rural poor. Inflexibility and Delay The rigid systems and procedures result in lot of time delay for the borrowers and demotivate them to take further loans. Lack of Transparency The microfinance industry has evolved from NGO roots. The push towards a „for-profit" status to the industry was primarily at the behest of banks. Working with a leading accounting firm, MFIs came up with an innovative idea and for-profit trusts were constituted which took in money as „contributions" from a large base of „clients" or „members". The corpus thus created with

the trusts was invested as capital in the NBFCs. It was widely believed at that time that the clients putting money in the trusts were not aware that this was actually an equity investment. These trusts over a period of time disappeared or reduced in size with the promoters or investors buying out the community without, at least in some cases, sharing with them the growth and returns. Hence, while the route of forming trusts was not illegal, and was perhaps dictated by the need to bring in the much needed equity, the sectoral grapevine was abuzz with tales of unethical, and in some cases illegal, behaviour of MFI promoters. The way the issues were handled by the concerned MFIs and by other sectoral stakeholders, in terms of transparency and ethical/legal issues, left a lot to be desired. High Transaction Costs, both Legitimate and Illegal Although the interest rate offered to the borrowers is regulated, the transaction costs in terms of the number of trips to be made, the documents to be furnished etc. plus the illegal charges to be paid, result in increasing the cost of borrowing. Thus, making it less attractive to the borrowers. Private Equity Push The transformation of microfinance institutions to an NBFC format, largely pushed by banks and supported by the Small Industries Development Bank of India through its „Transformation Loan‟ helped a for-profit orientation to emerge. Large institutions were able to bring down operating costs, and the operating cost ratio reduced to 8.5% in 2008 from 15.4% in 2006. Total cost ratio also came down drastically to 17.6% from 23.4% in the same period. As against this, interest rates for ultimate clients continued to hover at around 30%, and the industry margins were quite attractive. The high margins and the seemingly limitless market, considering the poverty levels in India brought private equity (PE) players to the sector. The industry stakeholders and banks welcomed this move as it was seen as a coming of age of the sector. A few voices expressed their concern that the entry of PE players would lead to rapid growth and commercialisation at a scale not seen before, but these were quickly brushed aside in the initial euphoria. The entry of PE players changed the game quite comprehensively. The money brought in was short term money and needed high returns of the order of 24-30%.6 The only way such returns could be realised was through rapid growth. The more money that was leveraged on account of equity, and the faster it was turned around, the more would be the profit. Growth, which till then was being supported by all stakeholders, became an end in itself and was driven by profit - the client and her needs scarcely factored. Meaningless Growth The growth in coverage of microfinance is limited to pockets, and MFIs across the country have developed a tendency to congregate in select areas. It is very common to find urban and peri-urban settlements to have between 10-20 microfinance institutions operating within a small geography. This has led to the problem of multiple lending, which has raised the issue of client over indebtedness, default and strong arm recovery tactics. On occasions, charges have also been made of client suicide because of repayment pressures, but this appears to be more a figment of the imagination of the vernacular press than corroborated by any evidence on the ground. Hence, multiple lending is a well-known phenomenon and the sector has continued with an ostrich-like attitude to the problem. Despite evidence from across the globe, no efforts have been made to address the short-comings of the group-based lending product and collection methodology, which remains almost exactly as it was when imported in the late 1980s.

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