Variorum Multi-Disciplinary e-Research Journal
Vol.,-03, Issue-III, February 2013

A Study on Need and Importance of Micro Finance-Self Help Group

Prof. Vinod S. Chandwani: Asst. Professor. Vpm's Joshi – Bedekar College, Thane

Abstract

As the name suggests, microfinance is the provision of financial services in the form of loans, savings and insurance to people on a small scale, such as businesses with low or moderate incomes. Microfinance is a general term to describe financial services to low-income individuals or to those who do not have access to typical banking services. The theory is that if the poor have access to these services, their financial lives will be more stable, predictable and secure, allowing them to plan and improve their livelihoods through education, healthcare and empowerment. The global economic crisis has caused turmoil across the financial markets and global banking systems. Liquidity has declined as financial institutions tightened lending practices leading to tightening of credit in most of the world's major financial centers and has set off worldwide concerns about the resulting credit crunch hurting the real economy.

Objective

Microfinance is the provision of financial services to low-income clients, who traditionally lack access to banking and related services.

The objective of this paper is as follows:

- To understand the role and importance of microfinance as economic growth tool
- To articulate the challenges for microfinance providers and borrowers
- To study the various models of microfinance.

Introduction

Microfinance offers to the poor the access to basic financial services such as loans, savings, money transfer services and micro insurance. People living in poverty require a diverse range of financial services to run their businesses, build assets, manage operations and risks.

The credit for the development of micro finance concept goes to Mr. Muhammad Younus the founder of Grameen Bank of Bangladesh and the Noble Prize winner for Economics in 2006. In India, the concept of micro finance was introduced in 1992 with the launching of **SHG-Bank Linkage Programme** by NABARD.

Credit is either available from informal moneylenders at a very high cost without security or through a variety of informal erratic channels like chit funds, etc. Also banks have not considered poor people to be a viable market. However with microfinance, this scenario is changing as different types of financial services providers for poor people have emerged like NGOs, cooperatives, SHGs, commercial and state banks, insurance and telecommunications companies, post offices, etc. offering new possibilities for mobilizing funds to the poor.

Role and Importance of Microfinance.

1. Micro finance is provided to poor people in rural areas and in urban areas.
2. It is a instrument in generating employment.

Variorum Multi-Disciplinary e-Research Journal
Vol.,-03, Issue-III, February 2013

3. It increases the production of goods and services.
4. Micro finance facilitates women empowerment. In 2010 75% of SHG were formed by women.

5. **<u>Following information shows the importance clearly:</u>**

   Under the SHG-BLP, as on 31-3-2011, the details are as follows:
   1. 76.6 lakh (7.5 million) SHGs held saving bank accounts with total savings of Rs. 7,016 crore.
   2. 47.87 lakh (4.8million) SHGs had outstanding bank loans of Rs. 31,221 crore.
   3. The gross non-performing assets in respect of SHGs were 4.7% of the banks outstanding loans of banks to SHGs.
   4. New SHGs financed by the banks were about 12 lakhs with a total bank credit of Rs. 15,548 crore.

Problems to the micro-financier

1. **Perceived High Risk of Micro Entrepreneurship**

   MFIs attribute a high credit risk to micro entrepreneurs due to lack of adequate collateral against loan and alternate source of income to secure repayments compelling them to charge high interest rates on the loans.
2. **High Costs for Small Transactions**

   The small size of micro enterprises increases the transaction cost for MFIs because they cannot process loans in bulk denying the benefit of economies of scale. Hence they are forced to cover their costs through high interest rates ranging from 30 to 70% a year as per the ADB study
3. **Lack of Debt and Equity Funds for MFIs**

   Because of its growing popularity and current global financial crisis, there is an emerging shortage of funds for the microfinance sector pushing the interest rates up.
4. **Difficulty in Measuring the Social Performance of MFIs**

   Although microfinance is delivering the economic returns its proponents promised, there are few tools available that measure the social return of loan programs for the poor making it challenging to gather funds because donors would like to understand the actual impact made by microfinance.

Variorum Multi-Disciplinary e-Research Journal
Vol.,-03, Issue-III, February 2013

5. **Lack of Customized Solutions for the Poor**
   Due to the varied needs of micro entrepreneurs, MFIs find it difficult in targeting of poor households by microfinance programs. Lack of data and formal research hampers innovation/ development of customized microfinance tools for each micro entrepreneur.
6. **Lack of microfinance training for Human Resource in MFIs**
   Microfinance activity spreads across wider geographical area requiring microfinance staff to understand the nuances of different segments, which facilitates in building lasting relationships with individual micro entrepreneurs and evaluation of the borrower's sustainability.
7. **Poor Distribution System of MFIs**
   Microfinance involves more than 10,000 MFIs operational worldwide, catering to over 140 million poor families. With such high coverage, still nearly 1.5 billion of world's population is below poverty line. As the spread of needy people is across large geographical areas and often in remote places, it becomes inaccessible for MFIs to reach most of these markets.
8. **Dual mission of MFIs to be Financially Sustainable as well as Development Oriented**
   For maximizing profit, MFIs tend to forget their main objective of social development and end up targeting the same individual for multiple loans burdening individual borrower by mounting interest payments leading to further poverty and suicide cases.

Problems of microfinance borrower

1. **Inability to offer collateral**
   Microfinance borrowers are either very small businesses or poor individuals who usually have few assets and low income levels. Hence they are unable to offer any collateral to MFIs against loans which lead to loans at higher interest rates or no loan
2. **Poor viability of micro ventures**
   Poorly articulated business ideas with respect to demand and costs results in unsustainable micro venture. Microfinance borrowers often end up using the loan for personal expenses.
3. **Lack of knowledge**
   Many micro entrepreneurs live in far off geographically wide spread rural areas and have little formal education which leads to lack of knowledge about the existence of financial services and little access to microfinance services.
4. **Shortage of Financial Capital or Misallocation**
   Only 10 million out of 500 million people running micro enterprises have access to financial support for their businesses resulting in low availability of funds from microfinance borrowers. Also funds are misallocated to a small section of society as

Variorum Multi-Disciplinary e-Research Journal
Vol.,-03, Issue-III, February 2013

nearly 20% of the world's population accounts for 86% of consumption. Without credit, the micro ventures may not grow or take advantage of an immediate opportunity.

5. **Few organizational resource**
   Micro entrepreneurs have limited skills, qualifications, exposure to handling businesses and training. These prove as obstacle for their growth.
6. **Low bargaining power**
   Most of the micro entrepreneurs operate in competitive market with intermediaries to support demand fulfillment resulting in fragmented operations and lower bargaining power.
7. **Vulnerability to economic shocks**
   Micro entrepreneurs are particularly susceptible to sudden changes in customer demand or natural calamities or climatic conditions like rainfall, etc. because their businesses cannot sustain losses owning to their small size and need for increased working capital.

Models of Micro Finance

Micro Finance is provided through two models:

1. Self Help Group-Bank Linkage Programme
2. Micro Finance Institutions

A. SHG-Bank Linkage Programme:

This programme was introduced by NABARD in 1992. Under this programme SHGs are linked with the banks. Under this programme, three models have emerged:

Variorum Multi-Disciplinary e-Research Journal
Vol.,-03, Issue-III, February 2013

I Model 1 – SHGs are promoted and financed by banks. This is possible where in areas where there are bank branches.

Ii Model 2 – SHGs are promoted by NGOs/Govt. agencies and financed by banks. The NGOS assist the poor in setting up of micro units, and also assist in obtaining funds from the banks.

iIi Model3 – SHGs are promoted by NGOs and financed by banks through financial intermediaries. This model is especially operated where there are no bank branches. As per RBI Report 2011, only 5% of India's villages (about 32,000 out of 6,38,000 villages) are covered by banks.

B. Micro Finance Institutions:
   MFIs (include NGOs, trust, social and economic entrepreneurs) lend small amount of loans to individuals or SHGs. They also provide other services such as capacity training, and marketing of produce.
   MFIs operate under the following models:

1) Bank Partnership Model:
   I MFI as an Agent: The bank lends the money to SHGs, The MFI acts as an agent between the bank and the borrower – right from the application for loan to the final repayment.
   Ii MFI as Holder of Loans: The MFI provides small loans to individuals or SHGs, and then securitizes the loans (creates securities against the loans) and sells them to a bank. Thus, MFI is in a position to collect money from the bank which was earlier lent to several small clients.

2) Business Facilitator/Correspondent Model:
   In 2006, RBI permitted banks to use the services of NGOs, MFIs and other intermediaries in providing micro finance to the poor. The banking facilitators are intermediaries who undertake banking functions in villages/areas where there are no bank branches.

Administrative Expenses as Percentage of Loan Portfolio by Region	
Asia	**18.9%**
Eastern Europe	**20.1%**
Latin America	**23.3%**
Africa	**38.2%**

Portfolio Yield by Scale of Operation	
Large MFIs	**31.6%**
Medium MFIs	**43.4%**
Small MFIs	**48.2%**

Criticisms in the functioning:

a. The rates are very high due to huge operation costs.

Variorum Multi-Disciplinary e-Research Journal
Vol.,-03, Issue-III, February 2013

b. According to Olivia Donelly, Executive Director of UK-based Shivia Microfinance a non-profit firm- "The job of Micro finance is to alleviate poverty so the question is to ask Who's going to benefit from the IPO?"
c. Is it correct to make millionaires out of shareholders when borrowers are so poor?

Conclusion

As need for transparency increases and funds become dearer, micro financiers need to segment the clients to provide customized solutions. Government should formulate a policy and regulatory framework to monitor the contribution of MFIs and control quality of micro credit. A concession/ exemption for MFIs would release funds and encourage larger banking group to look at microfinance as a new business avenue. Technology-based microfinance solutions resulting from partnerships between commercial banks, MFIs and telecom firms would deliver financial services to geographically dispersed areas. Government should create awareness among micro credit users to manage micro credit in adept way and deploying funds in right ventures giving adequate returns to repay loans on time thereby ensuring improved creditworthiness in the microfinance market.

Bibliography

- Indian Microfinance – The Challenges of Rapid Growth – Prabhu Ghate
- Professional Banker March 2010, Global Economic Crisis – Impact on Microfinance
- Professional Banker March 2010, Managing Poverty through SHGs
- Watson, Y. (2009). From Crisis to Catharsis: How Microfinance Can Make it Through the Global Recession. Microfinance Insights. 11 (1), 1.
- Martin (2010). Transparency in Microfinance and the Global Economic Crisis: Baseline Predictions
- http://www.microfinancefocus.com/news/tag/rbi/
- RBI - Report of the Internal Group to Examine Issues Relating to Rural Credit and Microfinance, 2005, H. R. Khan
- Microfinance Information exchange, Inc – micro banking Bulletin, Issue 19, December 2009