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RESEARCH ARTICLE

TO SHOWCASE THE EFFECTS OF MICROFINANCE IN ACHIEVING FINANCIAL INCLUSION IN INDIA.

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Abstract

The present paper highlights the microfinance and role of microfinance in achieving financial inclusion in Indian Economy. The concept of Micro Finance is not new in India. Traditionally people have saved with and taken small loans from individuals and groups within the context of self help to start businesses or farming ventures. Majority of poor are excluded from financial services. Microfinance is a programme to support the poor rural people to pay its debts and maintain social and economic status in the villages. Microfinance is an important tool for improving the standard of living of poor. In spite of many organizations of microfinance, microfinance is not sufficient in india.The potential of growing microfinance institution in India is very high., as it is supported by government of India to achieve greater financial inclusion and growth in the country's priority sector. The study explores problems in microfinance sector and suggestions to make microfinance more effective in Indian economy to benefit major section of society and to achieve greater Financial Inclusion with the help of Microfinance Institutions.

Microfinance:-

"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."

In microfinance people who take loan are from low income group and loan amount is small (micro credit). Loans are provided without collateral and for short duration time. The loan is taken for income generation purpose. And repayment of loan is high in frequency.

Microfinance program is indented to reach poor segments of society as they lack access of financial services. So it helps to include excluded category in the mainstream for banking services to take benefit of banking services.

Microfinance is not only to provide micro credit to poor but it is a tool to development of the society. It covers wide range of services like credit, savings, insurance, remittance and also non-financial services like training, counseling etc.

Financial Inclusion:-

Financial inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of disadvantaged and low income segments of society, in contrast to financial exclusion where those services are not available or affordable.

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So the Financial Inclusion meaning is each and every individual should have access to affordable institutional financial products\services.

As financial exclusion is a great concern for developing nation globally. Access to financial services plays a critical role in facilitating economic development and growth for the country. Inclusive financial system allows poor people to smoothen their consumption and stand in difficult time as in illness, accident, theft, unemployment. Financial inclusion helps poor to save and borrow and to invest in education and employment and to live a better and progressive life.

Inclusive finance helps mainly disadvantaged group such as women, households, youth, and rural communities. This is why financial inclusion has gained prominence in recent years, across the world to improve the lives of the poor. And to make this possible large number of accounts were opened in banks under Jan Dhan Yojna by Prime Minster Narendra Modi.

Excluded sectors in financial inclusion:-

Financially excluded section includes:-

1. Marginal farmers
2. Landless labourers
3. Self employed and unorganized sector enterprises
4. Urban slum dwellers
5. Migrants
6. Ethnic minorities and socially excluded groups
7. Senior citizens and women etc

The Government of India and the RBI has a goal of promoting Financial Inclusion:-

According to RBI estimates data states that there are 450 million people do not have access to banking services in India and they belong to rural areas mostly. They have no access of formal financial services and they particularly rely on informal financial services like the people they know or money lender who usually exploit them and charge higher interest rates.

Therefore the Indian government and the RBI have come with the policy of “Financial Inclusion”. In this the Government requires Indian banks to lend to priority sector one of which is rural people. And banks lend money to MFIs who would then on- lend funds to poor women and rural people.

How Microfinance can help in Financial Inclusion:-

There is realization that in countries all income levels are not served by the adequate and formal financial system. Financial inclusion includes expanding the access to financial system at an affordable cost. A 2006 UN report on building inclusive financial sectors for development defined an inclusive financial system as one which provides credit to all “bankable” individuals and firms, insurance to all insurable individual and firms, and savings and payment services for everyone.

Financial inclusion doesn’t mean that everyone will use the financial services but it means that everyone has option to use them. They should have access to use financial services for better standard of living in the society. Low and irregular income is often primary reason for financial exclusion on both supply and demand sides, as it leads to lack of availability of suitable financial products as well as lack of motivation to open accounts as inability of the individual to save.

In developing countries the growth of Micro Finance Institutions (MFIs) which specifically target low income individuals are viewed as potentially useful for promotion of financial inclusion. Even though MFIs at present only offer credit products, as they grow they would start offering other financial services also. So partnering with MFIs, mainstream financial services providers could expand their reach.

Problems:-

Legal structure and regulations:-

The SHG bank-linkage model is well managed in India by NABARD but there is no proper regulatory body for supervision of MFIs. The presence of institutions with a variety of legal forms makes it difficult for the regulation of all such institutions by a single regulatory body in the current Indian legal structure. Though NBFCs, which cover the major part of the outstanding loan portfolio by the microfinance channel, are regulated by Reserve Bank of India, other MFIs like societies, trusts, Section-25 companies and cooperative societies fall outside the purview of RBI's regulation. The acceptance of the Malegam committee recommendations by the RBI is a big step forward in addressing the above concern but again it will cover only a section of the MFIs i.e. NBFCs. The microfinance bill which was introduced in the year 2007 is still pending. The most recent and the strongest step taken by the government, The Micro Finance Institutions (Development and regulation) Bill, 2011 is a major step in the microfinance sector. The proposed bill clarifies all doubts pertaining to regulation of the MFIs by appointing RBI as the sole regulator for all MFIs.

Financial illiteracy:-

One of the major problems in growth of Micro Financial Institution is the financial illiteracy of the people. This makes it difficult in creating awareness of microfinance and even more difficult to serve them as microfinance clients. Most of the microfinance institutions claim to have educational trainings and programmes for the benefit of the people, according to some of the experts the first thing these SHG and JLG members are taught is to do their own signature. The worst part is that many MFIs think that this is what financial literacy means. We all know how dangerous it can be when one doesn't know how to read but he/she knows how to accept or approve it (by signing it)

Inability to generate sufficient funds:-

MFIs are unable to raise sufficient fund remains one of the important concern in the microfinance sector. And NBFC's are able to raise funds through private equity investment because of the for profit motive, such MFIs are restricted from taking public deposits .not for profit companies which constitute a major chunk of the MFI sector have to primarily rely on donations and grants from government and apex institutions like NABARD and SIDBI. In absence of adequate funding from the equity market, the major source of funds for MFI are the bank loans, which is the reason for high debt to equity ratio of most MFIs.

Dropouts and migration of group members:-

Majority of the loans disbursed on the concept of group lending and past records of group plays an important role in getting new loans either through SHG-Bank linkage or through MFIs. The two major problems with the group concept are dropouts (when one or more member leaves the group) and migration (when one or member moves to another group). Most MFIs lend on the basis of past record of the group SHG or JLG and also on repayment performance. In absence of decent past record, members are deprived of getting bigger loan amounts and additional services.

Transparent Pricing:-

Transparent pricing in the microfinance sector has been an older one, it is gaining significance with the growing size and the increasing competition in the sector. Non-transparent pricing by MFIs confines the bargaining power of the borrowers and their ability to compare different loan products, because they don't know the actual price. In absence of the proper understanding of the pricing, clients end up borrowing more than their ability to payback which results in over-indebtedness of the borrower. Ambiguity in the pricing by MFIs is inviting regulatory bodies to implement strict measures like interest rate caps. But simply putting an interest rate cap may encourage MFIs to look for clients with larger loan requirements. This may deprive the clients with smaller loan requirements who are supposed to be the actual beneficiary of microfinance.

Cluster formation – fight to grab established market:-

MFIs' drive to grab an established market and reduce their costs is resulting in formation of clusters in some areas leaving the others out of the microfinance outreach. By getting an established microfinance market, MFIs reduce their initial cost in group formation of clients, educating them and creating awareness about microfinance. This cluster formation is restricting MFIs from reaching to rural areas where there is the actual need for microfinance. People in urban and semi-urban areas are already having access to microfinance through SHG-bank linkage or individual lending, but in rural areas people don't have access to banks and so SBLP is not much active in such areas. Because of the initial cost involved in serving a new location, MFIs are not willing to go to such remote locations. This is the reason most of the MFIs have their branches in urban and semi-urban areas only resulting in a very low rural penetration of microfinance.

Multiple lending and over- Debtness:-

Microfinance is one such sector where the Neo-liberal theory of free market operation fails, at least to some extent. Though competition is good for many sectors but in this case it is going against both the parties. In order to cover each others' market share, MFIs are ending up giving multiple loans to same borrowers which in some cases is leading to over-indebtedness (a situation where the borrower has taken loans more than her/his repaying capacity) of the borrower. MFIs are getting affected because borrowers are failing to make payments and hence their recovery rates are falling, while over-indebtedness is making the borrower go to depression and in some cases forcing them to commit suicide.

Suggestions and Conclusion:-

The following suggestions will help Micro Finance to be more effective. The suggestions are drawn from evaluation of various articles and secondary sources. The suggestions are as follows:

1. **Proper regulation:**
   The regulation was not necessary in initial times but as with growing competition and environment is changing proper regulatory framework is important.

2. **Field supervision:**
   Field visits can be adopted as a medium for monitoring the conditions on ground and initiating corrective action if needed. This will keep a check on the performance of ground staff of various MFIs and their recovery practices.

3. **Encourage rural penetration :**
   It has been seen that in lieu of reducing the initial cost, MFIs are opening their branches in places which already have a few MFIs operating. Encouraging MFIs for opening new branches in areas of low microfinance penetration by providing financial assistance will increase the outreach of the microfinance in the state and check multiple lending. This will also increase rural penetration of microfinance in the state.

4. **Complete range of products:**
   MFIs should provide complete range of products including Credit, Savings, Remittance, Financial advice and also non-financial services like training and support. As MFIs can provide various range of products to the people who do not have access to banks.

5. **Transparency of Interest Rates:**
   MFIs charge different rate of interest to different section of society. And they also charge additional rate of interest. So it makes all the procedure very confusing and borrower find himself incompetent to understand the rate of interest and often quit or unable to use bargaining power.

6. **Technology to reduce operational cost:**
   MFIs should use latest technology to reduce operational cost. And it is evident micro finance institutions which use latest technology and IT they reduce their operational cost and enhance proper utilization of resources.

Conclusion:-

It can be concluded from the above discussion that Micro Finance Institutions are growing and expanding at large but there is still need to penetrate the rural market, where the Micro Finance Institutions are not interested to expand their business because of high operational cost and poor infrastructure. But they are the real people who need the banking services and micro finance institutes substitute banks and provides financial services. As Micro Finances are great way to accomplish financial inclusion in the country so government should take initiatives to betterment of the Micro Finance Institutions.

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