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ANALYSIS OF FINANCIAL PERFORMANCE OF MICRO FINANCE INDUSTRY

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ABSTRACT

New micro finance approaches have emerged in India over the past decade, involving the provision of thrift, credit and other financial services and products, with the aim to raise income levels and improve living standards. The most notable among these micro finance approaches is a nationwide attempt, pioneered by Non Governmental Organizations and now supported by the state, to create links between commercial banks and NGOs and informal local groups. Micro finance through Self Help Groups (SHGs) is propagated as an alternative system of credit delivery for the poorest of the poor groups. Recognizing their importance, both Reserve Bank of India and National Bank for Agriculture and Rural Development (NABARD) have been spreading the promotion and linkage of SHGs to the banking system through refinance support and initiating other proactive policies and systems. This paper attempts to give a comprehensive overview of all aspects of micro finance in India - its essence, the different institutions involved in its promotion, the different modes of delivery, its weakness and the challenges that lie ahead, the programme of micro finance that has made rapid strides in India .

INTRODUCTION

Financial sector policies in India have long been driven by the objective of increasing financial inclusion, but the goal of universal inclusion is still a distant dream. For a financial system to be truly inclusive, it should meet the needs of everyone who can fruitfully use financial services, including the poor.

For the developing countries like India, microfinance has come as a breakthrough in the philosophy and practices of poverty eradication, economic empowerment and inclusive growth. Yet given the enormity of economic compulsions and complexities in developing countries, microfinance is an unfinished agenda. However, over the last several years, the Indian microfinance industry has undergone considerable evolution. The poor need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. It is achieved through investing money received through micro finance with or without the help of NGOs in business depending upon their capacity and capability.

It is expected that micro finance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. Researches and studies show that there is need for deepening / new product / different model for microfinance as the existing level has not helped them sufficiently to come out of poverty. MFIs are the pivotal overseas organizations in each country that make individual microcredit loans directly to villagers, micro entrepreneurs, impoverished women and poor families. An overseas MFI is like a small bank with the same challenges and capital needs confronting any expanding small venture but with the added responsibility of serving economically-marginalized populations. Many MFIs are creditworthy and well-run with proven records of success, many are operationally self-sufficient.

Various types of institutions offer microfinance: credit unions, commercial banks, NGOs (Non-governmental Organizations), cooperatives, and sectors of government banks. The emergence of "for-profit" MFIs is growing. In India , these 'for-profit' MFIs are referred to as Non-Banking Financial Companies (NBFC). NGOs mainly work in remote rural areas thereby providing financial services to the persons with no access to banking services.

The term "transformation," or commercialization, of a microfinance institution (MFI) refers to a change in legal status from an unregulated nonprofit or non-governmental organization (NGO) into a regulated, for-profit institution. Regulated, transformed organizations differ from nonprofits in that they are held to performance and capital adequacy standards and are supervised by a financial authority, typically the central bank of the country where they are registered. A transformed MFI also attracts equity investors. The equity investors want to ensure that the values of their investments are maintained or enhanced and elect Board members who share a common vision for the new for-profit institution. Among transformed MFIs, varying classifications of regulated institutions exist, the strictest being banks - rural banks and thrift banks - followed by non-bank financial institutions. Different countries have varied names for these regulated MFIs

MAIN FEATURES OF THE MICRO-FINANCE

It is a tool for empowerment of the poorest women.

It is essentially for promoting self-employment; the opportunities of wage employment are limited in developing countries - micro finance increases the productivity of self-employment in the informal sector of the economy - generally used for (a) direct income generation (b) rearrangement of assets and liabilities for the household to participate in future opportunities and (c) consumption smoothing. It is not just a financing system, but a tool for social change, specially for women Micro credit is aimed at the poorest; micro-finance lending technology needs to mimic the informal lenders rather than the formal sector lending. It has to:

a) Provide for seasonality

(b) Allow repayment flexibility

(c) Eschew bureaucratic and legal formalities

(d) Fix a ceiling on loan sizes.

New micro finance approaches have emerged in India over the past decade, involving the provision of thrift, credit and other financial services and products, with the aim to raise income levels and improve living standards. The most notable among these micro finance approaches is a nationwide attempt, pioneered by Non Governmental Organizations and now supported by the state, to create links between commercial banks and NGOs and informal local groups. Micro finance through Self Help Groups (SHGs) is propagated as an alternative system of credit delivery for the poorest of the poor groups. Recognizing their importance, both Reserve Bank of India and National Bank For Agriculture and Rural Development (NABARD) have been spreading the promotion and linkage of SHGs to the banking system through refinance support and initiating other proactive policies and systems. This paper attempts to give a comprehensive overview of all aspects of micro finance in India - its essence, the different institutions involved in its promotion, the different modes of delivery, its weakness and the challenges that lie ahead, the programme of micro finance that has made rapid strides in India.

BANK-SHG LINKAGE PROGRAMME

A sizeable share of population in India continues to remain outside the formal banking system despite considerable expansion in branch network. Alternative models are being experimented with to meet the objective of financial inclusion. The SHG-Bank linkage model is the indigenous model of micro-credit evolved in India and has been widely acclaimed as a successful model. SHG-Bank linkage programme is considered a promising approach to reach the poor and has since its inception made rapid strides exhibiting considerable democratic functioning and group dynamism. The SHG-Bank linkage model was introduced in 1991-92 with a pilot project of linking 500 SHGs with banks. This figure has gone up to more than 34 lakh by the end of March 2008. Cumulatively, these SHGs have accessed credit of Rs. 22,268 crore from banks during the period. About 4.1 crore poor households have gained access to the formal banking system through the programme. During the last nine years the number of SHGs linked to banks has gone up from 32,995 during 1998-99 to 34,77,965 during 2007-08. This shows an impressive 68 per cent compound annual growth rate. The compound annual growth rate for the cumulative bank loan to SHGs is even more impressive at 94 per cent, i.e., close to doubling each year. The faster growth in bank loans to SHGs has led to almost a four-fold increase in the average loans per SHG from Rs. 16,816 in 1999-2000 to Rs. 63,926 in 2007-08. These figures reflect the outstanding success of the programme

SPATIAL DISPARITY IN THE SHG-BANK LINKAGE PROGRAMME

Notwithstanding the remarkable progress, geographically there has been a skewed development of SHG-Bank linkage programme in India. There is wide regional disparity both in terms of the spread of SHGs linked to banks and cumulative bank loans disbursed under the programme. In March 2008, while the Southern Region accounted for 48.2 per cent of the total SHGs, the share of North- Eastern Region was just 3.4 per cent. In terms of share in the total bank loans to SHGs, the region-wise differential gets further magnified.

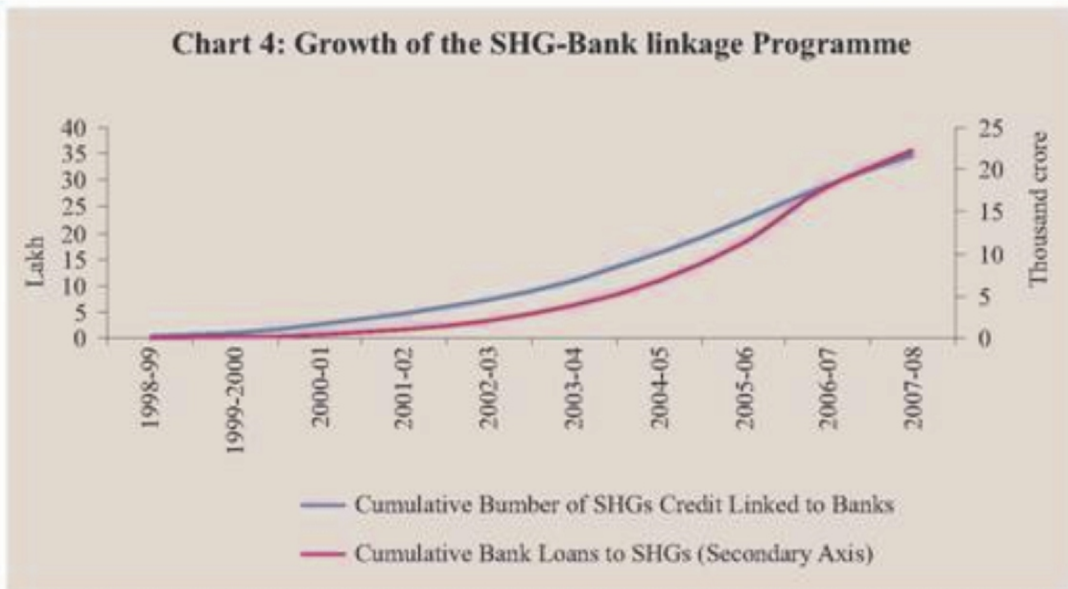

Table 8: Region-wise Progress of SHG-Bank Linkage Programme

(As on March 31, 2008)

Regions	Share (%) in Total					
	No. of SHGs	Loans to SHGs (Rs. crore)	Average Loans per SHG (Rs.)	No. of SHGs	Loans to SHGs	SHGs per Lakh Population
1	2	3	4	5	6	7
Northern	2,30,740	851	36,899	6.6	3.8	156
North Eastern	1,19,520	327	27,364	3.4	1.5	283
Eastern	6,72,626	2,372	35,268	19.3	10.7	274
Central	4,05,707	1,501	36,990	11.7	6.7	142
Western	3,74,561	1,320	35,254	10.8	5.9	229
Southern	16,74,811	15,896	94,915	48.2	71.4	703
All India	**34,77,965**	**22,268**	**64,027**	**100.0**	**100.0**	**310**

Source: NABARD

Some Highlights of SHG Bank Linkage Program

Physical

Total number of SHGs savings linked with banks : 69.53 lakh

Out of total [of which] exclusive Women SHGs : 53.10 lakh

Out of total [of which] - SGSY SHGs : 16.94 lakh

Total number of SHGs credit linked during 2009-10 : 15.87 lakh

Out of total [of which] exclusive Women SHGs credit linked : 12.94 lakh

Out of total [of which]-SGSY SHGs credit linked : 2.67 lakh

Total number of SHGs having loans outstanding as on 31

March 2010 : 48.51 lakh
Of which exclusive Women SHGs : 38.98 lakh
Of which-SGSY SHGs : 12.45 lakh
Estimated number of of families covered upto 31 March 2010 : 97 million

Financial

Total savings amount of SHGs with banks as on 31 March 2010 : Rs 6198.71 crore
Out of total savings of exclusive Women SHGs : Rs 4498.66 crore
Out of total savings of SGSY SHGs : Rs 1292.62 crore
Total amount of loans disbursed to SHGs during 2009-10 : Rs 14453.30 crore
Out of total loans disbursed to Women SHGs : Rs 12429.37 crore
Out of total loans disbursed to SGSY SHGs : Rs 2198.00 crore
Total amount of loans outstanding against SHGs as on 31 March 2010 : Rs 28038.28 crore
Out of total loans o/s against Women SHGs : Rs 23030.36 crore
Out of total loans o/s against SGSY SHGs : Rs 6251.08 crore
Average loan amount outstanding per SHG as on March 2010 : Rs 57795
Average loan amount outstanding per member as on 31 March 2010 : Rs 4128

Preface of Status of Micro Finance in India 2010 - Nabard Report

The Self Help Group (SHG)-Bank Linkage Programme, in the past eighteen years, has become a well known tool for bankers, developmental agencies and even for corporate houses. SHGs, in many ways, have gone beyond the means of delivering the financial services as a channel and turned out to be focal point for purveying various services to the poor.

The programme, over a period, has become the common vehicle in the development process, converging important development programmes. With the small beginning as Pilot Programme launched by NABARD by linking 255 SHGs with banks in 1992, the programme has reached to linking of 69.5 lakh saving-linked SHGs and 48.5 lakh credit-linked SHGs and thus about 9.7 crore households are covered under the programme, envisaging synthesis of formal financial system and informal sector.

In view of the large outreach and pre-dominant position of the microFinance programme, it is important to keep a continuous track of the status, progress, trends, qualitative and quantitative performance comprehensively. To achieve this objective, Reserve Bank of India and NABARD issued guidelines in the year 2006-07 to Commercial Banks, Regional Rural Banks and Cooperative Banks to furnish data on progress under microFinance. The data so collected covers various parameters like savings of SHGs with banks, bank loan disbursed to SHGs, bank loan outstanding against SHGs, gross non performing assets of bank loans to SHGs, recovery performance of loans to SHGs. Further, the banks also furnished the data regarding bank loans provided to Micro Finance Institutions (MFIs). NABARD, has been bringing out the consolidated document annually.

Consolidated data obtained from the banks along with preliminary analysis of the various trends and progress under microfinance sector under the two models viz., SHG - Bank Linkage model and MFI - Bank Linkage model. The data furnished by the banks have been analysed on a region-wise, state-wise, agency-wise, bank-wise and also for SHGs

exclusively under Swarnajayanti Gram Swarojgar Yojana and exclusive women SHGs data in the booklet.

The trend in submitting the Management Information System by banks has shown improvement. This year all 27 Public Sector Commercial Banks, 19 private sector Commercial Banks, 81 Regional Rural Banks and 318 Co-operative Banks have submitted the MIS. We thank all the banks for furnishing the data and expected that in the coming years all the remaining banks will co-operate in timely and accurate submission of data to us.

The major support provided by NABARD under Micro Finance Development and Equity Fund relates to promotion and nurturing of SHGs by Self Help Promoting Institutions and training and capacity building of the stakeholders in the Sector. NABARD is also experimenting innovative projects for further developing the microFinance through Joint Liability Groups. The details in thisregard are also included in this booklet.

We hope that all the stakeholders under microfinance sector would use the information as input and feedback relating to the sector for bringing about policy changes and improvement in operational strategies. More analysis than what is given in the book is expected from all the microfinance players. NABARD would welcome suggestions and comments on this booklet formaking it more informative and useful at all levels in microfinance sector.

MICROFINANCE AND WOMEN EMPOWERMENT

Links between microfinance and women's empowerment are viewed as optimistic, limited by design, cost effective in eliminating poverty, and a misplaced diversion of resources. Microfinance programs range from small scale self-help groups to large poverty-targeted banks. One model may vary in delivery, group functions and structures, and complementary services. There could be 3 contrasting approaches to microfinance and women's empowerment: the financial sustainability approach, the integrated community development approach, and the feminist empowerment approach. In most programs, women benefited to a limited degree. Many women did not control the loan use. Most women were engaged in low paid, traditionally female activities, and increases in income were small. Resources and time invested in economic activity were limited by responsibility for household consumption and unpaid domestic work. Microfinance programs sometimes created domestic tension between spouses and loss of spousal income and support. Group repayment pressures sometimes created pressures between women. Many women focused on personal rather than social objectives.

CONCLUSION AND RECOMMENDATIONS

Microfinance has emerged as a vital approach to meet the heterogeneous needs of the poor. In India, microfinance in the formal sector has assumed the form of SHG-bank linkage program. Through this program, the Reserve Bank of India and NABARD have tried to promote relationship banking, i.e., "Improving the existing relationship between the poor and the bankers with the social intermediation of the NGOs." The SHG-bank linkage program in India is rapidly expanding its outreach under the pioneering initiative of NABARD, the monitoring and supervision of RBI, and the promotional policies of the government of India. At the grass root level the program is being implemented by the commercial banks, cooperatives, and regional rural banks, with government agencies. Pro-activeness of the rural folk and artisans is need of the Hour.

1 Access to Credit

The poor people's access to credit may be significantly improved through all the channels of SHG-Bank linkage programme, MFIs, Cooperative Banks, State Financial Corporations, RRB s and PACS. Some MFIs (i.e. Grameen Bank model/LABS, NBFCs) have been doing very well in selected states with dynamic markets and dynamic individuals. Beyond these jurisdictions, their outreach is non-existent. Any significant up scaling of micro-finance at the all India level will have to depend, therefore, on the large network of banks, the bank-SHG linkage programme and the MFIs. In addition, the post office network in the country may also be used to deliver banking services, especially in remote rural areas. The post offices may be further encouraged to work as "business facilitator" and as "banking correspondent" in accordance with RBI guidelines. The NABARD may consider setting up a Committee, consisting of various private and public sector banks, the Ministry of Rural Development, Small Industries Development Organisation (SIDO) of Ministry of Small Scale Industries (SSI), Rashtriya Mahila Kosh (RMK) of The Ministry of Women and Child Development, Department of Posts, SIDBI, MFIs and the NGOs in the micro finance sector to evolve an effective strategy to implement the Business Facilitators and Correspondents Model. Such a strategy should also take into account special target groups such as the SCs/STs and the minorities through their respective National Finance Corporations. The Eleventh Plan may target to extend micro-finance to at least 80 percent of the BPL households.

2 Formation of Consortiums by Banks

Both public and private sector banks have the expertise in financial intermediation. All the banks should come together and formulate a strategy at the national level to cover all regions of the country and to address the needs of the MFOs. The different banks may form 'consortiums' to leverage each other's advantages and work out suitable strategies to address the needs of micro-finance at the national level. Relevant 'Guidelines on Micro-Finance' both for the MFI model and the Bank-SHG linkage model, may be prepared by NABARD for the field level officers. Some incentives may also be introduced to encourage lending to the poor. Internal monitoring may also be further strengthened to check exploitation of the poor by unscrupulous elements.

3 Uniform Legal Framework

To facilitate the expansion of micro credit, the Centre should prepare a model Bill on Money Lending and circulate it among the State Governments requesting them to enact similar state legislations. The Reserve Bank has constituted a 'Technical Group for Review of Legislations on Money-lending'.. This draft bill can be used as an input for preparing model bill by the Central Government.

4 National Policy on Micro Finance

At present, both Government and the private agencies involved in micro finance have devised their own individual strategies in furtherance of their goals. Absence of comprehensive national level policy has hindered the orderly growth of the sector. There is an urgent need for a concerted effort on the part of the various agencies and the services providers involved in the sector to come together to evolve a coordinated strategy for a faster and smoother growth of the sector. The proposed bill on micro finance may address some of the issues. The 'regulator' proposed in the 'Bill' may have to come out with a detailed strategy on issues like coordination among various agencies, accounting and auditing, transparency, good governance, consumer protection, micro insurance, statistics & research, rate of interest, subsidies etc., keeping in mind the fact that the strength of the micro-finance industry lies in its informality and flexibility.

5 Uneven Geographical Growth

One of the major reasons for the uneven growth of the sector is the absence of conducive socio-economic and political set-up. NABARD introduced special incentives in the north, north-eastern and western states. The Ministry of Rural Development, Ministry of Small Scale Industries, NABARD and SIDBI may devise further need based incentive schemes for a faster and even growth of the sector in all parts of the country in consultation with Ministry of Finance and RBI. SIDBI has also taken positive steps to reach the underserved states through the portfolio risk fund scheme of the ministry of SSI and through its own special efforts.

6 Mobilisation of Savings by MFIs

The absence of savings, apart from SHGs and MFI cooperatives, has unfortunately been one of the features of Indian Micro finance and it prevents providing financial service to the poor. The Indian MFIs survive on borrowed funds, unlike other countries where savings fund a large share of lending. The regulatory environment only allows cooperatives to collect savings. The MFIs may be allowed to mobilise savings at least from their members under a regulatory framework monitored by the NABARD. The proposed Microfinance Bill is expected to address this issue.

7 Cost Covering Interest Rates

There is a need to create awareness of the need to charge cost-recovering interest rates. The rate of interest charged by the MFIs depends upon the cost of funds, cost of delivery and payment, cost of purchasing bad debts and cost of margins. For economic viability and sustainable growth, the MFIs need to charge interest rate covering these costs. Various studies conducted on this aspect indicate that MFIs normally charge 21-24 % interest rate for their sustenance. Innovative techniques must be identified to reduce the cost and the interest rate. The cost of delivery and collection of payment, which forms a major component of cost, can be reduced substantially by using the proposed Common Service Centres, which can be shared by other agencies also. The sector should make all attempts to reduce the rate of interest by means of efficiency enhancing innovations with the aid of technology.

8 Credit-Linked Subsidy

The policy of providing credit-linked subsidy to SHGs and individuals may be revisited. There are SHGs which are borrowing from banks on a continuous basis without claiming subsidies. A comprehensive study may be commissioned to study the incidence and effects of subsidy as part of the 11th Plan and to work out modalities and long term strategies to use the subsidies more productively and effectively.

9 Role of Technology

The network of internet enabled Information and Communication Technology (ICT) access points termed as Common Service Centres (CSC), 100000 in number across the country being implemented by the Department of Information Technology (DIT), Ministry of Communications and Information Technology, Government of India also may be utilized for improving the reach and spread of various Micro-Finance and Poverty Alleviation Schemes in rural areas in the country. Further, the DIT may coordinate with NABARD, Ministry of Rural

Development, Sa-Dhan and PRADAN to integrate the 'Computer Munshi System' of accounting into the ICT enabled CSCs.

10 ATMs and Gramteller (rural ATM) may be located in the Post Offices. The Common Service Centres being developed by the Department of Information Technology may also be linked to Post Offices to synergise the technology induction with experience of Posts to handle financial products. The proposed multi-purpose unique ID based smart card system can also be utilised for effective delivery of micro-credit.

11 NABARD, SIDBI, Ministry of Rural Development, which is already working to evolve a standard book keeping procedure along with the Institute of Chartered Accountants of India, may come together to evolve a standardized, simplified and book keeping procedure for all forms micro finance organisations, which would not only understand the health of the micro finance organisation but also help in accurate and timely disclosure of financial statements and annual reports. Further, the 'Computer Munshi System' developed by PRADAN and which appears to have been adopted successfully for maintenance of accounts may also be integrated into the overall strategy of simplifying the accounting procedure.

12 Maintaining Standard Accounting System

The guidelines/best practices for SHG-Bank linkages and microfinance may be issued by NABARD, covering auditing and monitoring mechanisms. RBI may conduct evaluation studies as and when required.

13 Extension Services

Need for extension services in the different economic activities of crop husbandry, animal husbandry, agro & rural industries is being widely recognised for guidance and counselling of SHGs/individuals, to help them choose useful activities and acquire the required skills. These extension services may not always be provided in-house through the line departments of the State Government; rather they may be provided by the private sector (eg. NGOs/MFIs) adopting the PPP model reinforced by viability gap funding. The line departments may, nevertheless, continue to function as apex institutions determining the objectives and terms of contract for the private sector participation.

14 Micro Insurance

Micro insurance should be perceived as a key service in the financial needs package of the people and in conjunction with micro savings and micro credit could go a long way in keeping the vulnerable segment away from the poverty trap and could be an integral component of financial inclusion.

The Insurance Regulatory and Development Authority (IRDA) has notified Micro Insurance Regulations in November, 2005 with focus on the direction, design and delivery of the products including tie up with life and non life insurance players for integration of product to address various risks, introduction of a standalone Micro Insurance delivery channel consisting of NGO, SHG and MFIs., enlarging the service activities entrusted to micro insurance agent, issue of Policy documents in simple vernacular language etc.

The IRDA may continue to give adequate priority to the micro insurance sector with focus on removing the constraints and further developing the sector.

Micro insurance is increasingly offered by MFIs acting as agents of the insurance companies. Life insurance is common among MFI members and some of the members are also availing asset insurance, mainly loan financed assets. Insurance is less widespread under the SHG model. MFIs and other civil society organizations are beginning to offer health insurance, which is of greatest relevance for poverty alleviation. NABARD may consider coordinating with various insurance companies, SIDBI, Ministry of Rural Development, Ministry of SSI, NGOs and their associations to bring out flexible micro insurance schemes, covering not only loan financed assets but also life, health, crop, animal husbandry, etc .

15 Capacity Building

Some financial institutions, particularly SIDBI, are tying up with capacity building providers to provide assistance to the microfinance institutions. A need-based capacity building programme to meet the requirements of all categories of MFOs is essential to bring about sustainability in the sector. Some of the important areas of capacity building are transformation, best practices, interest rate management, delivery management, managing growth, risk mitigation, product designing etc. Additional infrastructure for capacity building may be created on PPP basis with appropriate government assistance.

16 Formalities to access the credit are required to be simplified to enable semi literate and illiterate customers to access credit. The delivery mechanism also needs to be simplified to provide easy access to both credit and working capital. Activities suitable for women may be identified taking into consideration their traditional skills. A variety of enterprises may be offered to the women to select the best suited for them. Constant feedback on the market would also enable the women entrepreneurs to improve the product designs and marketing.

17 Transparency

The borrower needs to be protected from practises like lending without regard for the borrowers ability to repay, deceptive rate of interest and abusive collection techniques. Borrowers /consumer protection laws may be designed to take care of abusive lending and collection practices by defining them and by making provision for effective complaint redressal mechanisms. The consumer protection laws must also provide for transparent discloser of interest rate, cost and other terms of lending. The consumer laws must also educate the consumer on good money management practices for earning, spending, saving, borrowing and investing.

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