Micro Finance: A Social Innovator

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INTRODUCTION

Microfinance is generally considered as a specialized financial tool - such as small loans, savings accounts and insurance policies available to poverty stricken and small businesses that do not typically have access to financial services. These services are recognized as one best way to empower individuals and an effective social innovator, specially for those who fall in the low income trap, to lift themselves out of poverty.

Microfinance can be viewed as an innovative attempt of the banking sector to provide financial products and services, primarily credit, to the poor and bridge the gap that commercial banking has not been able to fulfil and where philanthropy has not been able to go beyond pilot approaches to reach meaningful scale. However, the concept of microfinance itself is conceived with a different purpose than just providing the poor with access to capital. The main principle behind the approach of providing micro credits has been to meet the special goal of bringing innovation in the society by channelizing the potential, skill and talent of under-privileged, women and economically challenged people by empowering and engaging them in commercial and purposeful activities. At the heart of this principle is the concept of human development and the brotherhood of man expressed through people working together to achieve a better life for themselves and their children.

The concept that microfinance is an income producing tool rather than a consumption aid is an appropriate way of bringing social changes and transforming the society in the new and developed word. That is why microfinance and microcredit do not provide consumers with loans to simply increase their consumption instead, they provide loans for the specific purpose of creating self-employment for the poor, thereby enabling the poor to build their own micro enterprises and with the passage of time, they can become the owner of large size business houses and can create employment opportunities for needy and help them to beat the poverty.

The focus of micro finance on "poor" client is one innovative approach to bridge gap between haves and haves not. A balanced society depends upon balance pillar and micro finance is an effective tool to strengthen the weaker pillar. Some people are of the opinion that microfinance should focus on the "economically active poor," or those just at or below the poverty level. Others, on the other hand, suggest that microfinance institutions should try to reach the needy persons, but all have one common view that microfinance has the power to single-handedly defeat poverty.

Continuous innovations in the society by gearing up activities of those who fall in lower income traps by making small loans available to them demands sustainability of those institutes which are providing microcredit loans . **So, loans are designed to be offered at market rates of interest so that the MFIs can recover their costs but they should not be so high that they make supernormal profits off the poor. This is an important concept because institutions that charge high interest rates can be scarcely cheaper than the moneylenders they intended to replace, and institutions that charge subsidized rates can distort markets by undercutting other lenders that are attempting to recover their costs.** This has implications for impact assessments because the less clients must pay in interest, the more they could be expected to show in increased income. If we compare the impact of institutions that fall outside of "normal" microfinance interest rates, we could end up drawing unreasonable conclusions about the effectiveness of one program versus another, since each type of program attracts different clients and imposes different costs on their borrowers.

MICRO FINANCE AS AN INCOME GENERATING ACTIVITY

Microfinance programs offer motivated poor the capital they need to initiate income generating activities that will allow them to escape from poverty. Most poor people manage to mobilize resources to develop their enterprises and their dwellings slowly over time. Financial services could enable the poor to leverage their initiative, accelerating the process of building incomes, assets and economic security. However, conventional finance institutions seldom lend

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down-market to serve the needs of low-income families and women-headed households. They are very often denied access to credit for any purpose, making the discussion of the level of interest rate and other terms of finance irrelevant. Therefore the fundamental problem is not so much of unaffordable terms of loan as the lack of access to credit itself **(Kim 1995)**.

The driving force behind the act of providing micro credit and small loan was to support the real beneficiaries for generating the source of income by opening their own enterprises. But one side of the coin reflects that poor don't have access to these small funding schemes. The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economic characteristics and financing needs of low-income households. For example, commercial lending institutions require that borrowers have a stable source of income out of which principal and interest can be paid back according to the agreed terms. However, the income of many self employed households is not stable, regardless of its size. A large number of small loans are needed to serve the poor, but lenders prefer dealing with large loans in small numbers to minimize administration costs. They also look for collateral with a clear title - which many low-income households do not have. In addition, bankers tend to consider low income households a bad risk imposing exceedingly high information monitoring costs on operation.

However, experience of small funding to poor from last 10 to 15 years has given surprising facts. It has been seen that by financing to small entrepreneurs, producers and poor people and giving them easy access to responsive and timely financial services at market rates, had made them serious to repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grass root savings and credit groups around the world have shown that these microenterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies. But the point is that sustainability and survival of micro finance institutes cannot be challenged at any cost. To the extent that microfinance institutions become financially viable, self sustaining, and integral to the communities in which they operate, they have the potential to attract more resources and expand services to clients. Despite the success of microfinance institutions, only about 2% of world's roughly 500 million small entrepreneurs is estimated to have access to financial services. **(Barry et al. 1996)**.

Albeit, there is demand for credit by poor and women at market interest rates, the volume of financial transaction of microfinance institution must reach a certain level before their financial operation becomes self sustaining. In other words, although microfinance offers a promising institutional structure to provide access to credit to the poor, the scale problem needs to be resolved so that it can reach the vast majority of potential customers who demand access to credit at market rates. The question then is how microenterprise lending geared to providing short term capital to small businesses in the informal sector can be sustained as an integral part of the financial sector and how their financial services can be further expanded using the principles, standards and modalities that have proven to be effective.

To be successful, financial intermediaries that provide services and generate domestic resources must have the capacity to meet high performance standards. They must achieve excellent repayments and provide access to clients. And they must build towards operating financial self-sufficiency and expanding client reach. In order to do so, microfinance institutions need to find ways to cut down on their administrative costs and also to broaden their resource base. Cost reductions can be achieved through simplified and decentralized loan application, approval and collection processes, for instance, through group loans which give borrowers responsibilities for much of the loan application process, allow the loan officers to handle many more clients and hence, reduce costs **(Otero et al. 1994)**.

Microfinance institutions can broaden their resource base by mobilizing savings, accessing capital markets, loan funds and effective institutional development support. A logical way to tap capital market is securitization through a corporation that purchases loans made by microenterprise institutions with the funds raised through the bonds issuance on the capital market. There is at least one pilot attempt to securitize microfinance portfolio along these lines in Ecuador. As an alternative, BancoSol of Bolivia issued certificates of deposit which are traded in the Bolivian stock exchange. In 1994, it also issued certificates of deposit in the U.S. (Churchill 1996). The Foundation for Cooperation and Development of Paraguay issued bonds to raise capital for microenterprise lending (Grameen Trust 1995).

Savings facilities make large scale lending operations possible. On the other hand, studies also show that the poor operating in the informal sector do save, although not in financial assets, and hence value access to client-friendly savings service at least as much access to credit. Savings mobilization also makes financial institutions accountable to local shareholders. Therefore, adequate savings facilities both serve the demand for financial services by the customers and fulfil an important requirement of financial sustainability to the lenders. Microfinance institutions can either provide savings services directly through deposit taking or make arrangements with other financial institutions to provide savings facilities to tap small savings in a flexible manner **(Barry 1995)**.

Convenience of location, positive real rate of return, liquidity, and security of savings are essential ingredients of successful savings mobilization **(Christen et al. 1994)**.

Consequently, rational and prudential financial regulations become necessary to ensure the solvency and financial soundness of the institution on the one hand and to protect the interest of depositors on the other. However, excessive regulations that do not consider the nature of microfinance institutions and their operations can hamper their viability. In view of small loan size, microfinance institutions should be subjected to a minimum capital requirement which is lower than that applicable to commercial banks. On the other hand, a more stringent capital adequacy rate (the ratio between capital and risk assets) should be maintained because microfinance institutions provide uncollateralized loans.

Governments should provide an enabling legal and regulatory framework which encourages the development of a range of institutions and allows them to operate as recognized financial intermediaries subject to simple supervisory and reporting requirements. Usury laws should be repelled or relaxed and microfinance institutions should be given freedom of setting interest rates and fees in order to cover operating and finance costs from interest revenues within a reasonable amount of time. The Government could also facilitate the process of transition to a sustainable level of operation by providing support to the lending institutions in their early stage of development through credit enhancement mechanisms or subsidies. Moreover, successful operation and sound functioning of the institutes providing mingy and meagre finances is demanded not only for upliftment of the financial deprived strata of the society but also for economic development of the nation. Recent work by the World Bank suggests that almost 30 per cent of employment in low-income countries is generated by the informal economy, while an additional 18 per cent is provided by (formal) small and medium enterprises. Together, these two groups contribute 63 per cent of the GDP **(Ayyagari, M., T. Beck and A. Demirguc-Kunt, Small and medium enterprises across the globe: A new database, World Bank Policy Research Working Paper)**. So we can smell the need to stimulate the role of microfinance institutes both in formal and informal sectors. One way of expanding the successful operation of microfinance institutions in the informal sector is through strengthened linkages with their formal sector counterparts. A mutually beneficial partnership should be based on comparative strengths of each sectors. Informal sector microfinance institutions have comparative advantage in terms of small transaction costs achieved through adaptability and flexibility of operations (Ghate et al. 1992). They are better equipped to deal with credit assessment of the urban poor and hence to absorb the transaction costs associated with loan processing. On the other hand, formal sector institutions have access to broader resource-base and high leverage through deposit mobilization **(Christen et al)**.

MICRO FINANCE -AS ROAD MAP FOR SMALL BUSINESSES

Credit for developing 'entrepreneurship culture' goes to the large extent to microfinance services offered by micro finance institutions. Micro level investments for running small business is really a panacea for fulfilling basic needs of down trodden in general and for eradication of poverty in particular. Microfinance not only empowers and employs the economically challenged people, but also engages them in performing purposeful activities and all these things are required for bringing social changes. Social transformation does not demand big miracles but meagre attempts to help poor for initiating small ventures can bring great results. There are different ways to fulfil this objective, but the role of the institutes engaged in providing micro credit facilities to poor is inevitable. For example, microfinance empowers depositors to lift up from the bottom to the middle of the economic pyramid as poor can satisfy their different sets of needs in the need hierarchy when they will start earning through their own enterprises. Moreover, the institutes providing loan facilities for opening new ventures also educates clients about how to start business and trains them for bringing desired results. Microfinance also helps individuals to utilize their skills and potentials which otherwise remain hidden because of non availability of finance. Above all, microfinance creates employment by facilitating small businesses and engages clients in activities for earning and for lifting their social status as well as economic level which helps to reduce the gap between two strata of people with high and low income levels.

RECENT TRENDS OF MICRO FINANCE SERVICES TO POOR

Microfinance institutions have adopted innovative ways of providing credit and savings services to the entrepreneurial poor. The different organisations in this field can be classified as "Mainstream" and "Alternative" Micro Finance Institutions. Some of the Mainstream Financial Institutions involved in extending micro finance are NABARD, Small Industries Development Bank of India (SIDBI), Housing Development Finance Corporation (HDFC), Commercial Banks, Regional Rural Banks (RRBs) and credit co-operative societies etc. Alternative Micro Finance Institutions are the institutions which have come up to fill the gap between the demand and supply for microfinance. These institutes have been structured with the main aim of providing thrift, credit and other financial services and products of very small amounts mainly to the poor, in rural, semi-urban or urban areas for enabling them to raise their income level and improve living standards.

FEW RECENT SCHEMES OF GOVERNMENT OF INDIA

The Govt. of India has initiated so many schemes for nurturing the life of poor in India. One among them is Micro-credit programmes run primarily by NABARD in the field of agriculture and SIDBI in the field of Industry, Service and Business .Over a period of time, NABARD has undertaken a number of other innovative schemes also and some more are still in the pipeline. Now, NABARD has been working as a catalyst in promoting and linking more and more SHGs to the banking system. Actually, it was visualized that such groups, when mobilize the surpluses generated by members of the group and finance the investments for the needy members ,can gear up economic engine of the people and help them to come out of the vicious circle of poverty. The stunning micro finance scheme of SIDBI which came into operation in January 1999 has proved to be a sharp edged weapon for attracting those who are at the bottom of the economic pyramid. Stepping up of flow of credit to the units in small scale sector through direct and indirect financing mechanism and ensuring speedy disbursement have remained the main plank of operational strategy of SIDBI.

SALIENT FEATURES OF MICRO FINANCE PROGRAMME OF GOVERNMENT OF INDIA

- **Arranging Fixed Deposits For MFIs/NGOs:** Under this scheme, the Government of India arranges money for MFIs/NGOs like SIDBI for micro credit to poor.
- **Training And Studies On Micro-finance Programme:** Government of India would help SIDBI in meeting the training needs of NGOs, SHGs, intermediaries and entrepreneurs and also in enhancing awareness about the programme. Institution building for 'intermediaries' for identification of viable projects: The Government of India would help in institution building through identification and development of 'intermediary organizations', which would help the NGOs/SHGs in identification of product, preparation of project report, working out forward and backward linkages and in fixing marketing/ technology tie-ups. The SISIs would help in the identification of such intermediaries in different areas.
- **Budgetary Provision For The Scheme During the 10th Plan:** There was a budgetary provision in 10th five year plan.
- **Administrative Arrangement:** A committee has been formed to control and monitor the administrative arrangement of MFIs/NGOs.

CREDIT MECHANISMS ADOPTED BY OTHER BANKS

- **HDFC Bank : 'Home Sweet Home'** is the dream of every one living on this cosmos. Though the poor cannot even think about having that sweet home- but they deserve to have at least a small house. HDFC has been making continuous and sustained efforts to reach the lower income groups of the society, especially the economically weaker sections, thus enabling them to realize their dreams of possessing a house of their own. For the purpose of actual implementation of the low cost housing projects, HDFC collaborates with organisations, both Governmental and Non-Governmental. Such organisations act as co-ordinating agencies for the projects involving a collective of individuals belonging to the Economically Weaker Sections. The projects could be either be in urban or rural areas. To date, HDFC has experienced 100% recovery for the loans disbursed to various projects. Branch staff now uses scorecards to evaluate microfinance loan applications quickly, which has reduced the cost of review and made microfinance lending programme profitable and convenient.

☸**ICICI Bank :** Two state banks in India (Corporation and Canara) partnered with an NGO to provide salaried low-income workers with access to savings. The project uses the already established automatic teller machines (ATMs) in the factories to offer a recurring savings product, along with education on personal finance.

☸**IRCI Bank :** Govt. of India set up Industrial Reconstruction Corporation in April 1971, with the main aim to provide reconstruction and rehabilitation assistance mainly to sick units. Other reason behind the formulation of this bank was to provide assistance for strengthening the commercial activities in the country and energize the livelihood of the sufferers. It grants loan and advances to weak and closed units.

CONCLUSION

Today, microfinance is a global growth industry. In order to further broaden its horizons and bring maximum benefits to people in general and country in particular, there is still need to have more drainage of funds to the dry destination of the society. No country can afford to ignore substantial population suffering from poverty as it can be costly for growth of any economy. So rational approach in this regard is to identify the strengths vested in such poor lot and attempts should be made to channelize their energy for productive purposes. In India, the need is to have more dissemination and adoption of rural agricultural microfinance methodologies as majority of population belongs to the rural area. It is a widely recognized fact that access to financial services can play a critical role in helping poor people to widen their economic opportunities, increase their asset base and diminish their vulnerability to external shocks. Moreover, socioeconomic development as well as macroeconomic and financial sector stability are important components in ensuring an enabling environment for continued growth of the overall economy as a whole and the micro finance industry in specific.

Empirical indications are that the poorest can benefit from microfinance from both an economic and social well-being point-of-view, and that this can be done without jeopardizing the financial sustainability of the MFI. While there are many biases presented in the literature against extending microfinance to the poorest, there is little empirical evidence to support this position. However, if microfinance is to be used, specific targeting of the poorest will be necessary. Without this, MFIs are unlikely to create programs suitable for and focused on that group.

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