

Microfinance: Dynamics Of Microfinance In India: The Road Towards Rural Development?

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Financial inclusion has been a very acute and pervasive problem among rural Indians. Their financial activities are limited to post office savings and borrowing from moneylenders, but not anymore, we have a new saviour, a real one this time, in the form of Microfinance. The success stories are unlimited and it actually is quite astonishing how such a simple concept of social responsibility, joint liability and micro credit had the potential to transform the face of Rural finance.

At the very outset of this article, let me introduce to you the very basic concept of Microfinance. As the term itself suggests, Micro pertains to small, and finance pertains to money. Therefore financial activities involving small amounts of money, in very basic terms is Microfinance.

Microfinance in its concept as we know today was conceived in rural Bangladesh, which has now gone on to become a dynamic force of financial services for the poor in the country, especially women, leading to their financial independence.

There are two models in which Microfinancial services are disbursed.

- **The SHG-Bank linkage model** – Under this, a group of 10 to 25 people (comprising of women or senior citizens, depending on the type of SHG) pool in their small savings to form mobile credit. This, they lend to each other on priority basis with group responsibility in loan repayment. Once the group establishes its discipline in lending and repayment, it can get credit from established banks for a fixed time period, which they repay, responsible as a group.
- **The Microfinance Institution-Bank Linkage model-** In this, the group directly takes loans under the joint liability method (the whole group is responsible for loan repayment) from the MFIs which in turn are funded by banks.

The motherland for Indian Microfinance is Andhra Pradesh, mainly because of the state government's critical efforts in the late 1980s in building SHG-bank linkage models with loans from NABARD (National Bank of Agriculture and Rural Development) which built up a strong Micro-finance portfolio.

Today, Micro-finance Institutions, which maybe banks, NGOs etc, are catching up as big players in this Industry. And from here starts the critical analysis, the have and have not's of this very lucrative and tremendously potential concept.

The whole concept of financial inclusion encompasses the need for Micro-finance. The rural poor up to a decade had zero access to normal banking services and were intermittently excluded from the same, thus they were dependent for credit on

moneylenders.

Today with SHGs and MFIs, the face of money lending is slowly changing.

The loan outstanding, according to the latest estimate by Microfinance Institutions Network (MFIN), the organization of 40 MFIs, is about Rs 30,000 crore with about 3 crore poor banking on MFIs for their financial needs. While the four southern states of AP, Tamil Nadu, Karnataka and Kerala account for a chunk of this borrowing, West Bengal and Orissa too have rural poor relying on MFIs.

Besides, the sector is also on an uptick in UP and Haryana.

We have to clearly understand that the sheer fact that micro-finance has succeeded with repayment rates up to 98% reported all across the country, is because of the small credit disbursed to a huge customer pool. The mere volume of transactions is the winner in this game.

Now, as expected micro-financial activities are not synonymous with profit, but of late many MFIs have come into existence and are making profits more than the banks which lend them credit, which is highly puzzling.

Also, many of these institutions, especially in AP, including India's largest registered microfinance Institution-SKS, have been blamed for discreetly charging interest rates as high as 25-26% and coercive loan collection methods.

They claim to charge a flat 10% interest rate on the credit balance, but instead even after the principal amount is repayed, the interest is charged on the original amount borrowed, which cumulatively adds up to 25-26% rate of interest.

Moreover the recent suicides committed by women and men unable to repay outstanding loans from MFIs, the number 54 up till now, has raised serious questions on the functioning of these MFIs, clearly violating the grounds of ethics and morality on which the whole concept was founded.

In purview of all this, the Andhra Pradesh government recently launched an ordinance, which through its legal regulations regarding financial activities has immediately put all repayment to MFIs on hold. This step has pushed the whole micro-finance sector into an unidentified, uncertain limbo.

The question is not whether Microfinance is viable or not. It has been tried and tested and has proven its potential as the most cost effective developmental tool. It is its effective long term sustenance that is questioned.

Till now, the government with its varied schemes, programs has invariably enjoyed the rural support in its initiatives. Now, they have an option, equally beneficial and viable, in the form of MFIs. The fact that more and more poor have been associating themselves with these institutions shows that how the rural India is gradually learning to make

choices once he is offered any. As I said, huge demand for rural credit, makes the rural population a potential market for these allied financial activities, and the government and the private players seem to be fighting for it.

Of course, MFIs have their own shortcomings. Competing MFIs tend to target the same set of people, leading to multiple lending and hence repayment defaults.

Thus, what we need is a cohesive effort to sustain microfinance in its essence, that is reaping benefits from it in the form of rural financial inclusion along with regulated but viable micro-finance institution whether profit or non profit. If this current micro-financial crisis that the country is facing is not handled tactfully by the government, which it has failed to do, by far, then probably we can lose hope to imagine, think and dream of what could've been. We can just hope that we overcome this glitch soon and set motion again to something that can not only improve rural finance but also act a source of mobilizing credit for social investment.