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Title

MICRO FINANCE – ROLE OF BANKING INTERMEDIARIES IN INCLUSIVE ECONOMIC GROWTH

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Abstract:

Micro finance is most challenging financial act of modern banks in India. It is a scaleable anti-poverty solution to rural credit barriers. The main objective of this study is to conceptualize the operational methodologies for formal microfinance institutions in rural India. The study reflects the supply of customized financial products that are offered by public and private sector banks in India. The study explains the different initiatives of banks product and approach differentiation towards micro finance. The study analyses the banks product design and customization of microfinance procedures and attempts to understand the concepts behind the credit customization. Under this study, microfinance product structure and innovations of banking institutions were reviewed. The success or failures of funding structure, product mix and product innovation were discussed. The study also reveals the success of SHG revolution and the degree of success contributed by product substitution and product innovation in banking Microfinance in rural India. It also reveals the challenges for banking institution in offering financial services for rural India.

Key words: Micro finance institutions, self *help groups, micro finance structure*

Introduction:

Financial services are mainly accessible for urban people in India. For any economy to have all-round development, it is necessary to ensure that all sections of the society are given equal justice in access to financial services. Indian rural sector is always denied of such financial facilities, and is a hindrance for the rural development. Financial institutions mainly look forward for urban people due to high income and credit worthiness. Large scales of Indian rural people are of low income and uneducated and difficult to measure their creditworthiness.

Objective of the study:

The objective of this study is outlining the banking intermediary role in financial inclusions in Indian economy and to compare the micro finance activities of State bank of India and ICICI bank. Also to bring out the comparative advantages of commercial banks in microfinance and challenges faced by commercial banks in microfinance endeavors.

Methodology:

Source of data:

Banking institutions notify from time to time the various financial activities rendered towards different sections of the society in their annual reports and websites. To satisfy the study objective the secondary source of data has been extracted from the official websites of the company.

Tools for data analysis:

It is a comparative study of the statistics with respect to the services offered by both SBI and ICICI bank. Different financial variable on similar lines has been compared between the banks to bring out better understanding of the service differentiation.

Microfinance – Background:

Large population of India even today leaves in rural vicinity and underprivileged of financial facility. Indian rural community needs finance for various activities like agriculture, cattle feeding, etc,. Microfinance is a proven tool for fighting poverty on a large scale. It provides very small loans, or micro-loans, to poor people, mostly women, to start or expand very small, self-sufficient businesses. Through their own ingenuity and drive, and the support of the lending microfinance institution (MFI), poor women are able start their journey out of poverty. Unlike commercial loans, no collateral is required for a micro-loan and it is usually repaid within six months to a year. Those funds are then recycled as other loans, keeping money working and in the hands of borrowers. For example, a woman could borrow Rs.50 to buy chickens so that she can sell their eggs. As the chickens reproduce, she can sell more eggs and eventually sell the chicks. As a borrower, she receives advice and support from the MFI that issued her loan, and support from other borrowers just like her. Some MFIs also provide social services, such as basic health care for her and her children. As her business grows and diversifies, she begins to earn enough to improve the living conditions for her and her family. Microfinance clients boast very high repayment rates. Averaging between 95 and 98 percent, the repayment rates are better than that of student loan and credit card debts in the United States.

MFIs are very client-focused. Some MFIs go directly to the borrower’s place of business to issue loans and collect payments. Other MFIs host weekly borrowers’ meetings at the local center where the transactions and other social services take place. During these center meetings, borrowers empower each other to stay on the path out of poverty by sharing successes and discussing ideas for solving business and personal problems.

Conceptual Understanding:

Microfinance programs are funded by loans, grants, guarantees and investments from individuals, philanthropists, social investors, local banks, foundations, governments, and international institutions.

“Microfinance” is often defined as financial services for poor and low-income clients. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as “microfinance institutions” (MFIs). These institutions commonly tend to use new methods developed over the last 30 years to deliver very small loans to unsalaried borrowers, taking little or no collateral. These methods include group lending and liability, pre-loan savings requirements, gradually increasing loan sizes, and an implicit guarantee of ready access to future loans if present loans are repaid fully and promptly.

More broadly, microfinance refers to a movement that envisions a world in which low-income households have permanent access to a range of high quality financial services to finance their income-producing activities, build assets, stabilize consumption, and protect against risks. These services are not limited to credit, but include savings, insurance, and money transfers.

Robinson (2001) defines microfinance as “small-scale financial services—primarily credit and savings—provided to people who farm, fish or herd” and adds that it “refers to all types of financial services provided to low-income households and enterprises.” In India, microfinance is generally understood but not clearly defined. For instance, if an SHG gives a loan for an economic activity, it is seen as microfinance. But if a commercial bank gives a similar loan, it is unlikely that it would be treated as microfinance. In the Indian context there are some value attributes of microfinance:

1. Microfinance is an activity undertaken by the alternate sector (NGOs). Therefore, a loan given by a market intermediary to a small borrower is not seen as microfinance. However when an NGO gives a similar loan it is treated as microfinance. It is assumed that microfinance is given with a laudable intention and has institutional and nonexploitative connotations. Therefore, microfinance is not by form but by the intent of the lender.
2. Second, microfinance is something done predominantly with the poor. Banks usually do not qualify to be MFOs because they do not predominantly cater to the poor. However, there is ambivalence about the regional rural banks (RRBs) and the new local area banks (LABs).
3. Third, microfinance grows out of developmental roots. This can be termed the “alternative commercial sector.” MFOs classified under this head are promoted by the alternative sector and target the poor. However these MFOs need not necessarily be developmental in incorporation. There are MFOs that are offshoots of NGOs and are run commercially. There are commercial MFOs promoted by people who have developmental credentials. We do not find commercial organizations having “microfinance business.”
4. Last, the Reserve Bank of India (RBI) has defined microfinance by specifying criteria for exempting MFOs from its registration guidelines. This definition is limited to not-for-profit companies and only two MFOs in India qualify to be classified as microfinance companies.

MICROFINANCE AND MICRO CREDIT:

Micro credit refers to very small loans for unsalaried borrowers with little or no collateral, provided by legally registered institutions. Currently, consumer credit provided to salaried workers based on automated credit scoring is usually not included in the definition of micro credit, although this may change.

Microfinance typically refers to microcredit, savings, insurance, money transfers, and other financial products targeted at poor and low-income people.

Financial Inclusion Services (FINS):

Financial Inclusion Services (FINS) – are provided to fulfill working capital & investment needs of the clients – the poor household. It includes savings, credit – short term and long term, insurance for lives and livelihoods, fund transfers, commodity derivatives, financial orchestration – ranging from grants to equity for livelihoods.

1. Insurance
2. Savings
3. Microcredit
4. Remittances

Micro Finance – Funding Structure:

FINANCIAL INCLUSION SERVICES (FINS)	Agricultural/Business Development Services (Ag/BDS)	INSTITUTIONAL DEVELOPMENT SERVICES (IDS)
Savings: (Direct and as Business Correspondent	Productivity enhancement through increase in yields or reduction in costs.	Individual level awareness, skill and entrepreneurship development, building solidarity and trust.
Credit: agricultural, allied and non-farm activities; loans for housing, water & sanitation, vocational training	Risk mitigation (other than insurance) – such as livestock vaccination	Formation of groups, federations, co-operatives, mutual benefits, etc., of producers.
Insurance for lives and livelihoods – health, crop, livestock, micro-enterprise assets	Local value addition through processing – such as cotton ginning or milk chilling.	Accounting and management information systems, using IT
Money transfer, for migrant workers and Micro-pensions	Alternate Market linkages - Input supply, output sales	Building collaborations to deliver a wide range of services
Warehouse receipts	Diversification from farm to allied and non-farm activity	Sector and Policy work – analysis and advocacy for changes/reforms.

Source:http://69.89.31.196/~basixind/index.php?option=com_content&task=view&id=47&Itemid=61

Challenges of Micro Finance - <u>MACRO STUDY OF MICRO FINANCE</u>

In this context, following strategic, institutional and connectivity issues related to micro-finance arise.

<u>Strategic Issues:</u>

- Is there a prevailing paradigm for micro-finance?
- Are there clearly visible pattern across the country?
- Is there a clearly defined foundation building blocks such as organizing principles, gender preferences and operational imperatives?
- What are methodological issues?

Institutional Issues:

- Is there a need for a new institution?
- Should it operate all India or in a state?
- Where should it be located?
- Who can lead an institution of this sort?
- What will its contextual interconnections be?
- Who will be its beneficiaries?

Connectivity Issues:

- How should the Corporate Financial Sector be involved?
- What is the role of donor agencies?
- How should communities be involved?
- Are there political issues that should be explicitly considered?
- Are there government policy issues?

Following risks are generally perceived by the formal sector financial institutions:

- Credit Risk
- High transaction and service cost
- Absence of land tenure for financing housing
- Irregular flow of income due to seasonality
- Lack of tangible proof for assessment of income
- Unacceptable collaterals such as crops, utensils and jewellery

Challenges for Bankers in offering Microfinance Services:

Most bankers have not regarded microfinance as a genuine option, however, because they have believed it unprofitable. When asked why they do not pursue microfinance, traditional commercial bankers have typically expressed three basic concerns:

1. Highly Risky: Bankers perceive small businesses and micro enterprises as bad credit risks. Many insolvent state-owned agricultural banks seemed to prove that small farmer clients could not or would not repay their loans. The perception is that small clients do not have stable, viable businesses for which to borrow and from which to generate repayment. Moreover, these potential clients lack traditional collateral to guarantee their loans. Finally, banks no doubt also recognize they do not have appropriate lending methodologies to serve these clienteles (that is, correct screening mechanisms to separate good from bad credit risks).

2. Too Expensive: Bankers also believe that because micro loans are small and have short terms, bank operations will be inefficient and costly. It takes the same amount of time and effort (if not more) to make a US$1,000 loan as a US$100,000 loan, but the return on the larger loan is much greater. So why make a small loan?

3. Socio-economic and Cultural Barriers: According to bankers, micro and small enterprise clients have difficulty approaching a bank because they lack education and do not possess business records to demonstrate cash flow. In many developing countries, social, cultural, and language barriers do not allow for an easy relationship with a modern banking institution. It is hoped, however, that with a more widespread diffusion of innovations in financial methodologies, reducing the risks and costs of micro lending, more banks will begin to incorporate micro entrepreneurs into their portfolios.

OBSTACLES FOR COMMERCIAL BANKS IN MICROFINANCE:

Banks lack, however, some key ingredients - most of all, the financial methodologies to reach a low-income population. They also face thorny internal constraints that must be overcome before they can produce a large, successful microfinance program. Our study of banks in microfinance identified at least six key related issues banks need to resolve to enter the microfinance market successfully:

Commitment: the commitment of commercial banks (particularly the larger banks) to micro enterprise lending is often fragile, and generally dependent on one or two visionary board members rather than based solidly in its institutional mission.

Organizational structure: Microfinance programs need to be inserted into the larger bank structure in such a way that they have relative independence and, at the same time, have the scale to handle thousands of small transactions efficiently.

Financial methodology: Banks need to acquire an appropriate financial methodology to service the microenterprise sector — financial innovations that permit a cost-effective analysis of creditworthiness, the monitoring of a large number of relatively poor clients, and the adoption of effective collateral substitutes.

Human resources: Given that microfinance programs differ so radically from traditional banking, banks must recruit and retain specialized staff to manage these programs. Issues of recruitment, training, and performance-related incentives require special consideration.

Cost-effectiveness: Microfinance programs are costly because of the small size of their loans and because banks cannot operate them with their traditional mechanisms and overhead structures. Strategies must be found to minimize processing costs, increase staff productivity, and rapidly expand the scale of their micro enterprise portfolios — that is, increase the number of loans. Banks must cover the costs of microfinance operations and specialized training through scale economies.

Regulation and supervision: Banks must communicate with banking authorities to ensure that reporting and regulatory requirements take into account the specialized nature of microfinance programs.

STATE BANK OF INDIA – A CASE STUDY:

SBI has taken up SHG movement as a mission.A noble mission to reach those families who were hitherto having no access to the credit by any formal financial institution and, therefore, were depending on informal sources and moneylenders.

MICRO FINANCE – DEEP ROOTS IN SBI:

Micro finance is not new to State Bank of India.Bank's association with non-government organizations (NGOs) or voluntary agencies in extending financial help can be traced as far back as 1976 well before NABARD introduced SHG-Bank Credit Linkage Programme as a pilot project in 1992.

STEADY GROWTH IN SHG-BANK CREDIT LINKAGE PROGRAMME:

SBI has actively participated in SHG-Bank Credit Linkage programme since its inception in 1992 as a pilot project of NABARD. Since then the Bank has made a steady progress in financing SHGs.As on March 2006, SBI's branches spread throughout the length and breadth of the country have opened 6,30,067 Savings Bank account of SHGs out of which more than 5.41 lac SHGs have been provided with credit facilities thus benefiting more than 75 lac poor people.Majority of these SHGs are women SHGs.The year-wise cumulative position of SHGs-Bank Linkage programme for the last 4 years is as under:

Year	March '07	March '08	March '09	March '10
SHGs linked (financed)	1,07,553	1,74,666	3,43,691	5,40,481
No. of beneficiaries	12,33,660	21,50,752	48,11,674	75,68,842
Amount disbursed	324.84 cr.	614.87 cr.	1311.45 cr.	2262.95 cr.
Amount outstanding	269.43 cr.	462.77 cr.	872.08 cr.	1459.89 cr.
No. of SHGs maintaining Savings a/c in the Bank	2,79,466	3,69,568	5,08,396	6,36,067
Amount in Savings a/c (Amt. in Rs.)	261.36 cr.	348.31 cr.	411.82 cr.	434.07 cr.

Source: state Bank of India website

SBI – LEADER IN SHG-BANK CREDIT LINKAGE

SBI is maintaining its position as a leader among Commercial Banks in credit linking of SHGs and is a prime driver for the movement.As at the end of March 2006, SBI with a share of approximately 47% of total SHGs financed by Commercial Banks is far ahead of others.

INNOVATIONS & INITIATIVES:

Bank has successfully initiated various measures toward widening its SHG network.To list a few examples:

(i). Sensitisation of staff: Bank's aim is to sensitise the entire staff from Manager to Messenger working in rural and semi-urban branches towards the programme.

(ii). Special training programmes in SHGs are being conducted at 54 training centres of the Bank in the country apart from State Bank Institute of Rural Development, Hyderabad.

(iii). Close liaison with NGOs: Operating functionaries at branch level and region level are in close contact with NGOs in their area to take the movement ahead.For the purpose, regular meetings are arranged with the NGOs and their support is solicited.

(iv).SHG cells: Special SHG cells have been opened at major branches.

(v).Lending to NGOs / Federations of SHGs: Lending to credible NGOs / Federations of SHGs on selective basis for on lending to SHGs is being encouraged.

(vi). Sahayog Niwas: SBI has launched its Housing Loan product 'SAHAYOG NIWAS' meant for SHG members.Under the scheme formulated keeping the socio economic conditions of villages insight, housing loans are given to the SHG members without any mortgage of house / land.Response to this product is very encouraging.

(vii). SBI Life - Shakti: SBI Life, our insurance subsidiary, is the first to introduce a life insurance scheme, especially designed for SHG members.Special feature of the scheme is that entire premium amount paid by the member is refunded after maturity, i.e., 10 years.

(viii). Rural training institutes: To help the rural youth to stand on their feet, two RUDSETI type training institutes have been established at Gulbarga and Gadag in Karnataka State, to impart training in self employment to youth free of cost.

(ix). SBI staff as SHPI: The main role of formation and nurturing of SHGs have been played by NGOs who, apart from their fundamental role of social service, also aim to make the poor economically self sufficient.But in SBI, our committed work force is not lagging behind and a number of committed staff members have worked hard to form and nurture SHGs on their own.

(x). Appreciation by Government: A number of our branches / Circles have also received commendation and appreciation from various State Governments for doing excellent job in SHG-Bank Credit Linkage programme.

NABARD felicitated 15 SHGs at a function organized in New Delhi on 13th September 2005.The function was presided over by the Hon'ble Union Finance Minister.Out of total 15 SHGs felicitated, 4 were financed by our branches, one each from Orissa, Jharkhand, Madhya Pradesh and Uttaranchal.

(xi). Samanwita: Bank has sponsored and financially supported NGO 'SAMANWITA' in collaboration with Government of Orissa for supplementing the process of socio economic upliftment of the tribals and the downtrodden in the poorest and most backward Kandhamal district of Orissa State where 52% of the population is that of tribals.Core activities performed by Samanwita is empowerment of people through promotion of SHGs, especially women SHGs and development of human resources.

(xii). SHPI status: State Bank of India is the first Commercial Bank to which NABARD has recently given SHPI status.

ICICI BANK – A CASE STUDY:

Micro BankingICICI Bank's commitment to the rural and urban low-income populations is based on the vision and strategic opportunity to reach the large number of Indians lacking access to financial services today. By focusing on three key enablers – partnerships, technology, and process & product innovation – ICICI Bank has built the foundation for scaling the delivery of financial services to the poor. Through a wide range of micro-credit and micro-savings offerings, ICICI Bank already touches the lives of millions of low-income households across India, and is looking ahead to expand its services in the future.

1. Micro Credit:

ICICI Bank provides financial assistance to the MFIs in the form of Term loan, Overdraft and Portfolio Buyout facilities. The Bank has established a dedicated micro finance development team responsible for providing these facilities to the MFIs.

Term Loan and Overdraft

Term loan is extended for on lending to micro finance clients. In addition to the above, the Bank extends Over Draft (OD) facility to tide over temporary cash flow mismatches. These facilities are extended to MFIs registered as Societies, Trusts, Not-for-profit Companies, Co-operatives, Credit co-operatives, MACS, CDS and NBFC.

Portfolio Buyout

ICICI Bank buys unencumbered, direct agricultural and/or weaker section portfolio originated by the MFI (registered as NBFC) through the process of Direct Assignments. These are bilateral transactions that are entered into directly between the MFI and the Bank. Above mentioned facilities are extended at the discretion of ICICI Bank.

2. Micro Savings:

Recognising the need for easy savings facilities for its low-income customers, ICICI Bank has pioneered the launch of micro-savings products under its 'Business Correspondent' model. ICICI Bank has partnered with NGOs, Societies, and Trusts - its 'business correspondents' - to deliver savings services to its low-income customers.

The micro-savings product provides the customer with access to a savings account with convenient features. The product combines security, convenience (proximity, convenient opening times and minimal paperwork), appropriate design (frequent deposits, small variable amounts and quick access) and positive returns.

Business Correspondents (BC) of ICICI Bank

ICICI bank renders micro credit and micro savings account facility through its business correspondents. These BC are responsible for identifying the eligible people for credit facility and collection and payments pertaining to these accounts. Following are the list of business correspondents of the bank.

S. NO:	Name of the BC
1	Association for Rural Development(ARD)
2	AVVAI Village Welfare Society(AVVAI)
3	National Mother and Child Welfare Organisation(NAMCO)
4	Center for Rural Education & Economic Trust(CREED)
5	Rural Development Mission(RDM)
6	Guidance Society for Labour Orphan and Women(GLOW)
7	Universal Welfare Fund(UWF)
8	Evangelical Social Action Forum(ESAF)
9	Vikas Gram Udyog Mandal(VGUM)
10	Society for National Education, Entrepreneurship & Development(Society for NEED)
11	ADHIKAR
12	Grameen Sanchar Society(GRASSO)
13	Prayas Juvenile Aid Center
14	Action for Women And Rural Development(AWARD)
15	Lucknow Mahila Sewa Trust(LMST)
16	FINO Fintech Foundation
17	Hindustan Co-op Credit Society Ltd(HCCS)
18	Mahila Chetna Manch
19	Sambhav Social Service Organistion
20	Unnati Mahila Sangh(UMS)

Abbreviations:

BC: Business correspondent

FWWB: Friends Women World Banking

MFI: Microfinance Institution

NABARD: National Bank of Agriculture & Rural Development

NGO: Non-Government Organisation

RRB: Regional Rural Banks

SIDBI: Small Industry Development Bank of India

SHG: Self Help Group

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