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FINANCIAL INCLUSION – THE MICRO FINANCE WAY

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INTRODUCTION

"Micro Finance" is often defined as financial services for poor and low-income clients. In practice, the term is often used 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.

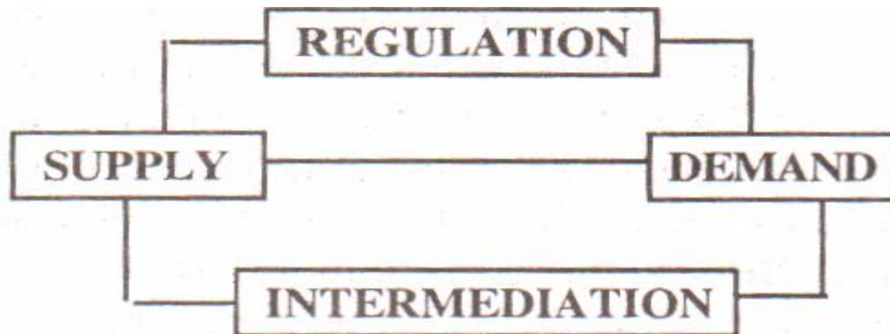
Micro finance clients are poor and low-income people that do not have access to other formal financial institutions. Microfinance clients are usually self- employed, household-based entrepreneurs. Their diverse "microenterprises" include small retail shops, street vending, artisanal manufacture, and service provision. In rural areas, micro-entrepreneurs often have small income-generating activities such as food processing and trade; some but far from all are farmers. Low earning women often comprise the majority of clients. Over the past decade, a few MFIs have started developing a range of products to meet the needs of other clients including pensioners and salaried workers.

Most microcredit borrowers have microenterprises — unsalaried, informal income-generating activities. Microloans may not predominantly be used to start or finance microenterprises. Research suggests that only half or less of loan proceeds are used for business purposes. The remainder supports a wide range of household cash management needs, including stabilizing consumption and spreading out large, lumpy cash needs like education fees, medical expenses, or lifecycle events such as weddings and funerals.

DYNAMICS OF MICRO FINANCE

Most MFIs started as not to profit organizations like NGOs (non-governmental organizations), credit unions and other financial cooperatives, and state- owned development and postal savings banks. An increasing number of MRs are now organized as for-profit entities, often because it is a requirement to obtaining a license from banking authorities to offer savings services. For-profit MFIs may be organized as Non-Bank Financial Institutions (NBFIs), Commercial Banks that specialize in microfinance, or microfinance departments of full service banks. E.g- SKS Microfinance Ltd, Spandana Sphoorty Financial Ltd, Share Microfin Limited, Asmitha Microfin Ltd, Shri Kshetra Dharmasthala Rural Development Project, Bhartiya Samruddhi Finance Limited, etc.

The four pillars of microfinance credit system are supply, demand for finance, intermediation and regulation. Whatever may the mode) of the intermediary institution, the end situation is accessibility of finance to poor. The following tables indicate the existing and desired situation for each component.



Microfinance can provide a range of benefits that poor households highly value including long-term increases in income and consumption. A harsh aspect of poverty is that income is often irregular and undependable. Access to credit helps the poor to smooth cash flows and avoid periods where access to food, clothing, shelter, or education is Lost. Credit can make it easier to manage shocks like sickness of a wage earner, theft, or natural disasters. The poor use credit to build assets such as buying land, which gives them future security. Women participants in microcredit programs often experience important self-empowerment. There is a strong indication from borrowers that microcredit improves their lives. They faithfully repay their loans even when the only compelling reason is to ensure continued access to the service in the future. Other microfinance services like savings, insurance, and money transfers have developed more recently, and there is less empirical research on their impact. Client

demand indicates that poor people value such services. MFIs that offer good voluntary savings services typically attract far more savers than borrowers.

ROLE OF GOVERNMENT IN SUPPORTING MICRO FINANCE

Government can contribute most effectively by:

- Setting sound macroeconomic policy that provides stability and low inflation
- Avoiding interest rate ceilings - when governments set interest rate limits, political factors usually result in limits that are too low to permit sustainable delivery of credit that involves high administrative costs – such as tiny loans for poor people. Such often have the announced intention of protecting the poor, but are more likely to choke off the supply of credit.
- Adjusting bank regulation to facilitate deposit taking by Solid MFIs, once the country has experience with sustainable microfinance delivery.
- Creating government wholesale funds to support retail MFIs if funds can be insulated from politics and they can hire and protect strong technical management and avoid disbursement pressure that force fund to support unpromising MFIs.

Financial services, particularly credit are not appropriate for all people at all times. For loans that will be used for business purposes, microcredit best serves those who have identified an economic opportunity and can capitalize on it if they have access to a small amount of ready cash. Too much risk is placed on the MR and client, when the only way a client can repay a Loan is by starting a successful business. Microfinance is particularly inappropriate for the destitute, which may need grants or other public resources to improve their economic situation. Basic requirements like food, shelter, and employment are often more urgently needed than financial services and should be appropriately funded by government and donor subsidies. Microfinance may or may not be able to respond to socio-economic problems such as relocation of refugees from civil strife, generating employment among demilitarized soldiers, or assistance following a natural disaster. Microfinance is certainly not a stand-alone intervention.

THERE ARE WEAKNESSES

One of the most successful models discussed around the world is the Grameen type The bank has successfully served the rural poor in Bangladesh with no physical collateral relying on group responsibility to replace the collateral requirements. This model, however, has some weaknesses. It involves too much of external subsidy which is not replicable Grameen bank has not oriented itself towards mobilising peoples' resources. The repayment system of 50 weekly equal instalments is not practical because poor do not have a stable job and have to migrate to other places for jobs. If the communities are agrarian during lean seasons it becomes impossible for them to repay the loan. Pressure for high repayment drives members to money lenders. Credit alone cannot alleviate poverty and the Grameen model is based only on credit. Micro-finance is time taking process. Haste can lead to wrong selection of activities and beneficiaries. Most of the existing rnicrofinance institutions are facing problems regarding skilled labour which is not available for local level accounting. Drop out of trained staff is very high. One alternative is automation which is not looked at as yet. Most of the models do not lend for agriculture. Agriculture lending has not been experimented. All the models lack in appropriate legal and financial structure. There is a need to have a sub-group to brainstorm on statutory structure / ownership control / management / taxation aspects / financial sector prudential norms. A forum / network of micro-financier (self regulating organization) is desired.

LESSONS CAN BE DRAWN

Some valuable lessons can be drawn from the experience of successful Microfinance operation. First of all, the poor repay their loans and are willing to pay for higher interest rates than commercial banks provided that access to credit is provided. The solidarity group pressure and sequential lending provide strong repayment motivation and produce extremely low default rates. Secondly, the poor save and hence microfinance should provide both savings and loan facilities. These two findings imply that banking on the poor can he a profitable business. However, attaining financial viability and sustainability is the major institutional challenge. Deposit mobilization is the major means for microfinance institutions to expand outreach by leveraging equity. In order to be sustainable, microfinance lending should be grounded on market principles because large scale lending cannot he accomplished through subsidies.

CONCLUSION

We may conclude that microfinance can contribute to solving the problem of inadequate housing and urban services as an integral part of poverty alleviation programmes. The challenge lies in finding the level of flexibility in the credit instrument that could make it match the multiple credit requirements of the low income borrowers without imposing unbearably high cost of monitoring its end-use-upon the lenders. A promising solution is to provide multi-purpose loans or composite credit for income generation, housing improvement and consumption support. Consumption loan is found to be especially important during the gestation period between commencing a new economic activity and deriving positive income. Careful research on demand for financing and savings behavior of the potential borrowers and their participation in determining the mix of multi-purpose loans are essential in making the concept work.

Eventually it would be ideal to enhance the creditworthiness of the poor and to make them more "bankable" to financial institutions and enable them to qualify for long-term credit from the formal sector. Microfinance institutions have a lot to contribute to this by building financial discipline and educating borrowers about repayment requirements.

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