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A CASE STUDY ON THE EVOLUTIONARY TRENDS OF INDIAN MICROFINANCE INSTITUTIONS (MFIs)

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Abstract: *In recent decades, Microfinance and Microfinance Institutions (MFIs) in India have proved their vital role not only in eradication of poverty and gender difference, but also in the changing scenario of poor households as reliable bank customers. Though, India is mostly viewed as a straggler in the area of microfinance, especially in the context of the immense outreach of MFIs in neighbouring Bangladesh, the Indian movement of Microfinance has achieved a considerable altitude, as a leader in micro-finance. Nearly all Indian MFIs have realised that they must affect out of the traditional path of service with welfare mode - NGO perspectives and become a professional service, in parliamentary procedure to be successful both in outreach and sustainability, as the next stage of business strategy. In fact, a numeral of the leading MFIs in India have begun to act out of the traditional styles of natural process based on the Bangladesh Grameen Bank model, cooperative credit societies and self-help group (SHG) -based financial services. Ultimately, some obstacles also ahead in their movements of Indian MFIs towards the commercially feasible way, which necessitate a legal framework with specific guidelines from the apex body like RBI and the Indian Union Government. This paper has portrayed the paradigm shift of Indian MFIs, their strategies towards the secondary goal of microfinance, crises and recent growth in the legal framework and the patronage of RBI & Indian Union Government, as a case analysis.*

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MICROFINANCE:

"Microfinance", a magical strategy has come to eminence of the whole Earth from the kindling point of Grameen Bank of Bangladesh associated with Dr. Muhammad Yunus, winner of the 2006 Nobel Peace Prize. For Yunus, microfinance can unleash the productivity of cash-starved entrepreneurs and bring up their incomes above poverty lines. It is a vision of poverty reduction that centres on self-help rather than direct income redistribution.

MICROFINANCE IN INDIAN CONTEXT:

"Micro finance is all about the provision of thrift, credit and other financial services and products of the very small amount to the poor in rural, semi urban and urban areas for enabling them to raise their standard of living", outlined by NABARD

In late years, Microfinance has proved its effort in the fastest growing poverty-reduction activities in the state. For reaching an efficiency of Microfinance in poverty eradication, an initiative has been laid-down by the End Poverty Foundation, California, USA in partnership with Micro Credit Rating International Ltd (M-CRIL), India for documenting, disseminating and promoting the adoption of the 'best practices' that facilitate the sustainable growth of the micro finance sector. In due course, the experience of M-CRIL indicates that the extent of innovation - by a select group of leading MFIs - in the practice of microfinance in India is at least equally large and may even exceed that in other Asian nations. To this extent, India may even be classified as a leader in micro-finance. Further, it leads new path to success, according to M-CRIL, India.

MICROFINANCE MODELS IN INDIA

Even though, there is n-number of models of Microfinance models with eclectic approach, four most important models prevalent as the following; such as

Model I - Individuals or Group Borrowers are financed directly by banks without the intervention / facilitation of any Non-Government Organisation (NGO).

Model II - Borrowers are financed directly with the facilitation extended by formal or informal agencies like Government, Commercial Banks and Micro-Finance Institutions (MFIs) like NGOs, Non Bank Financial Intermediaries and Co-operative Societies;

Model III - Financing takes place through NGOs and MFIs as facilitators and financing agencies;

Model IV - is the Grameen Bank Model, similar to the model followed in Bangladesh.

In India, Model II of Microfinance constitutes nearly 75% of the total micro-financing where activity / joint liability / Self-Help Groups are formed and nurtured by facilitating agencies and are related directly with banks for the function of obtaining recognition.

STRATEGIC APPROACH OF MFIs:

"Group Lending", otherwise recognized as "Joint Liability" is the principal methodology deployed by the Microfinance Institutions, which conveys a positive effect of high loan repayment rates for microfinance institutions and significant new lending practices. In the original models, customers were typically organized into little groups (popularly termed as SHGs: Self Help Groups) and required to guarantee each others' loan repayments, aligning their incentives with those of the bank. Today a more encompassing set of mechanisms is recognized as also contributing to microfinance successes—especially the credible threat to deny defaulters' access to future loans, with or without group contracts.

OBJECTIVES:

- ✓ To analyse the evolving trends and the business strategies of Indian Microfinance towards its self reliance.
- ✓ To analyse the recent advancement over the crises faced by Indian MFI(s).
- ✓ To analyse the need-felt of a legal framework for recognising Microfinance as NBFC.

METHODOLOGY:

This paper has aimed to break down the evolutionary trends and business strategies of Indian Microfinance towards self reliance as a case-study by analysing various reports on the execution of Indian MFIs and observations on current scenario for the sustainable growth of Microfinance in India, as post de-facto.

RESEARCH PROBLEM:

Though many Indian Microfinance Institutions (MFIs) have used up the honourable seats; till the recent crisis from the day of the month of their inception, few major MFIs have been taken to the limelight for misuse of the market dominance of MFIs to charge excessive rate, an unethical practice/service, non-compliance etc. Ultimately, State Governments entered as the Protector to curb the un-ethical practice. For instance, Andrapradesh state government has imposed a law with stringent rules. It also alarms the Indian Union Government to enact a law for regulating MFIs to be successful in their endeavour and service in sustained, viable manner and fetch down the unwanted scenes in the poverty eradication.

RECENT ADVANCEMENT OF INDIAN MFIs:

Certainly, Microfinance in India has proved its vital part not only in eradication of poverty and gender difference, but also in the changing scenario of poor households as reliable bank customers. Though, India is mostly viewed as a straggler in the area of microfinance, especially in the context of the immense outreach of MFIs in neighbouring Bangladesh, the Indian movement of Microfinance has achieved a considerable height. Nearly all Indian MFIs has realised that they must affect out of the traditional path of service with welfare mode - NGO perspectives and become a professional service, in parliamentary procedure to be successful both in outreach and sustainability. In fact, a numeral of the leading MFIs in India have begun to act out of the traditional styles of natural process based on the Bangladesh Grameen Bank model, cooperative credit societies and self-help group (SHG) -based financial services. As a consequence, there has been a considerable amount of innovation not only in the design of financial products/services and delivery systems employed by MFIs, but likewise in other operational practices including

- Legal Framework & Regulatory Mechanisms
- Governance and institutional arrangements
- Operational strategies - client promotion, competition, organisational structuring
- Management information systems development
- Financial management and accounting systems
- Internal control and external audit arrangements
- Human resource management, including staff incentive schemes.

Considering the external commercial borrowings (ECB) by MFIs, not-for-profit MFIs are not allowed to raise ECB. The current policy effective from 31 January 2004, allows only those Institutions registered under the Companies Act to access ECB for permitted end use in order to enable them to become globally competitive players.

RECENT CRISES IN INDIAN MICROFINANCE: MFI(s) IN PARTICULAR

Apart from issues like lack of quality group, internal control, subsidized funds or grants, and constantly increasing operating cost, Indian MFIs has also felt pressure by third-men intrusion from politics, in any form. By design, an Andhra Pradesh Micro-Finance Institution

(Regulation of Money lending) Act, 2010 has been indexed as the root cause for the collapse of microfinance in India and the State in particular, has no jurisdiction over microfinance institutions registered as non-banking financial company (NBFC), the RBI has told the AP High Court recently. Likewise, the RBI has indicated that the Andhra Pradesh Micro-Finance Institution (Regulation of Money lending) Act 2010 has its jurisdiction only on MFIs which are not NBFCs and not recorded as per the guidelines drafted by the RBI.

In fact, the AP Microfinance Ordinance was enforced on October 15, 2010, and subsequently made into an Act in the aftermath of a surge of suicides by the borrowers allegedly due to the coercive recovery practices by the MFI agents.

It is evident that the AP accounted for about 30 per centime of the total microfinance business which was pegged at Rs 30,000 Cr at country level, in 2010. “NBFCs being regulated simultaneously by the RBI and State Government will result in dual regulation, thereby adversely affecting the performance of the NBFC-MFIs and the involvement of the public,” the RBI said in an affidavit filed in the tribunal. This was in response to a writ petition filed by some MFIs questioning the legal validity of the AP MFI Act. “In case of NBFCs, the RBI has exclusive power to govern and monitor them. The provisions of the impugned Act are ultra virus the constitution of India so far as it deals with NBFCs,” it added.

The MFI Act mandates prior approval of the State Government authorities for every loan application of the borrower. The Act has also changed the MFIs collection cycle from weekly to monthly at a designated place. Fresh disbursals in the State have come to a standstill with the stringent norms set by the State Government. The State Government has the power to cancel the licence of the MFI in case of any violation of the rules of the Act. “Since the MFIs which are not shown under the impugned Act (AP MFI Act), cannot recover the loans granted by them, it would adversely affect the fiscal conditions of RBI-regulated NBFC MFIs”, the affidavit stated.

“It is apparent that the ‘draconian AP law’ against the practice of microfinance has thrown out ‘the baby with the bathwater’ of the high growth of MFIs and over-indebtedness of some clients. It has deprived millions of low income families in India (not just AP) of the credit services provided by MFIs. How this will be replaced with the sustainable provision of micro-credit services (as opposed to subsidized short term palliatives) is a question yet to be answered”- criticised by M-CRIL India.

INDIA'S MICROFINANCE BILL:

On 11 Feb 2014, a Parliamentary Standing Committee on Finance under the leadership of Mr. Yashwant Sinha, Former Finance Minister has rejected the Microfinance Institutions (Development and Regulation) Bill, 2012, with a suggestion of constitution of a unified and independent regulator for the entire micro finance sector as a whole, which may be termed as the Micro Finance and Development Regulatory council (MFDRC) with representatives from all agencies and institutions concerned like RBI, NABARD and SIDBI and the nominees from central government and MFIs. The Committee has also asked the government to bring a fresh legislation before the Parliament; with a wider consultation.

In fact, the previous Indian Union Government had tabled a much awaited legislation governing MFIs in the Indian Parliament, titled Microfinance Institutions (Development and Regulation) Bill, 2012, on on 29 May 2012. The bill had come up with slight modification of the original draft Microfinance Bill made available by the Ministry of Finance, Government of India on its website on 6 July 2011. The draft bill had also been widely received by industry observers last year as a major step forward in the government's battle with the microfinance sector. The tabling of this bill in Parliament furthers the process of rounding out the regulatory framework for microfinance that had been evolving since the outbreak of the microfinance crisis in India on 14 October 2010.

M-CRIL has also welcomed this bill as a means of providing MFIs, lenders and investors with a stable regulatory framework – free from political interference – within which to extend the scope of financial inclusion and provide low income families in India with all the financial services necessary to facilitate their daily lives. If this bill is passed by the Parliament with the suggestions, probably it shall signal the smooth-beginning of the end of the Indian microfinance crisis.

Major Highlights of Microfinance Institutions (Development and Regulation) Bill, 2012:

- Hereby, MFIs are defined as organisations providing micro credit facilities up to Rs 5 lakh, thrift collection services, pension or insurance services, or remittance services.
- This Bill defends beneficiaries from the misuse of market dominance by MFIs to charge excessive rates.

- This Bill aims to provide a legal framework to regulate and develop the micro finance industry.
- The Reserve Bank of India (RBI) shall control the micro finance sector; by setting an upper limit on the lending rate and margins of Micro Finance Institutions (MFIs).
- This Bill offers a proviso for creating of councils and committees of central, state and district level to monitor the sector and setting-up a Micro Finance Development Fund managed by RBI; proceeds from this fund can be used for loans, refinance or investment to MFIs.
- This Bill demands the RBI to create a grievance redressal mechanism.
- This Bill allows MFIs to accept deposits. Unlike banks, there is no facility for insuring customer deposits against default by MFIs. The minimum capital requirement is also lower, though RBI may prescribe higher requirements.
- This Bill says that RBI will manage the Development Fund for MFIs. NABARD has to be delegated by the RBI, with regulatory powers.
- Indeed, this Bill does not state that the constitutions of these committees are mandatory. Although it has the proviso for the creation of micro finance committees of central, state and district levels to oversee the sector.
- Though this Bill allows MFIs to provide pension and insurance services, it does not have the proviso for regulation by or coordination of RBI with the respective sector regulators.
- There is no provision for consultation with the Competition Commission of India.

PROSPECTS FOR RECOVERY FROM CRISES:

Though Microfinance has made a considerable change in the socioeconomic status of poor communities in Indian sub-continent, MFIs have to turn around in a commercial way of business for their sustainability without any political intrusion. Indian MFIs require enormous support in terms of funds, practical approach and administrative reforms by the way of legal framework, expertise in MFIs evaluation tactics etc. Also, MFIs necessitate to be reliance in their service without any political intrusion, ambiguous regulatory powers as strategic approach; especially in their functionalities like other non banking financial companies (NBFCs), instead of following the prevailing concept of their parental organisation; non profit organisation (NPO). The recent move of RBI in lifting foreign lending restrictions to non-banking financial companies and letting the rupee depreciate to slow the outflow of capital open a new gateway for Indian MFIs. Moreover, MFIs can sustain their progress because of their unique strategy and practice; particularly business volume and flexibility. In crux, if at all, the Indian Union government realises the need-felt for legal framework and realign the scenario, MFIs can face-out all obstacles and achieve the next level of lending business in a commercially viable way too. Otherwise, Indian MFIs will further get declined in the bottom line and haul deeply the Indian Microfinance and poor-needy into the irrevocable deprived-state, eventually.

LIMITATION OF THE STUDY:

This paper has analysed the evolutionary trend of Indian Microfinance towards its self reliance, comparatively advancement over the crises in particular. This Case analysis has been done only on the reports published by EDA Rural Systems Private Limited, Micro-Credit Ratings International Ltd and NABARD as part of the main research on Indian Microfinance.

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