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"MICRO-FINANCE: POLICY ENVIRONMENT AND REGULATION IN INDIA"

* **Dr. Ganesh Kathar,** *Dept. of Commerce, A.B. Arts and Commerce College, Deogaon (R), Dist. Aurangabad.*

I] INTRODUCTION

Micro finance has emerged as the latest instrument of poverty alleviation. The last two national budgets highlighted its role, while international financial institutions have supported it for several years. Though this recognition by the Government has given the micro finance sector a recognised status, it has not changed the content of the main anti-poverty programmes of the Government. In other words the Government has not incorporated any lessons from the micro finance experience into its anti-poverty programmes. The Task Force deliberated intensively on a working definition of mF and proposes to define it as: **"Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi urban or urban areas for enabling them to raise their income levels and improve living standards".**

The growth of microfinance initiatives and institutions over the past decade and a half must be placed in the context of overall developments in the rural credit scenario in order to comprehend the reasons for the emergence of micro-finance products and their particular appeal to poor borrowers. One interpretation of the growth of the microfinance movement in India is that it developed as a direct result of and in answer to the failure of official attempts to address the credit needs of the poor; it is thus an articulated civil society response to the policy drift in the rural sector during the 90s. This view must contend with the reality that official policy has pioneered several micro-finance instruments through institutional channels; many of them specifically targeted the rural poor and they did expand the rural credit network and improved access to institutional credit by the poor.(1)

It must also be noted that the most widely prevalent model in the sector, i.e. the SHG-bank linkage model, seeks to leverage the impressive network of banks and financial institutions in the country, which are products of earlier efforts to push rural credit. The major change in policy that supported the model to take off was the RBI's decision allowing banks to lend to groups – not just to individuals in groups – even if they were not registered, but provided they functioned according to the norms required of registered bodies. Sa-Dhan, an association of major microfinance institutions in India, estimated the credit use of families below the poverty line at Rs 495 billion in 1998 based on annual needs of Rs 6,000 for rural families and Rs 9,000 for urban families.1 Of this, Rs 240 billion (49 percent) was for rural consumption, Rs 120 billion (24 percent) was for rural production, Rs 74 billion (15 percent) was for urban consumption, and Rs 61 billion (12 percent) was for urban production. (2)

Basically, the MFIs in India are of three categories: (i) Not for profit MFI, which include the NGOs (ii) Mutual Benefit MFIs, which include mutually-aided co-operative credit & (iii) for Profit MFIs, which include the Non-Banking Financial Companies (NBFC). (3)

II] RESEARCH METHODOLOGY

Review of Literature

From time to time, many researcher in India as well as abroad have devoted a lot of effort to study the microfinance Institute & regional growth/ Rural development relationship. The available literature on the relating issues just through light on the importance of the co-operation & contribution of the microfinance institution for the regional development. But don't focus on 'Regulation Policy and legal issues of the microfinance sector. Keeping in mind the existing gaps in literature it was though appropriate to undertake the present study with regard to the following objectives.

Objective of the Paper

The Paper is prepared to achieve the following objectives:

- Review the microfinance services for rural development in Indian context.
- To identify gaps from Regulation Policy and legal issues of the microfinance sector.
- To provide specific recommendations for innovative microfinance services, policies, approaches and delivery mechanisms for poverty eradication and livelihood development.

Methodology of the study

The study was designed for an intensive review of the development of microfinance services for rural people and Regulation Policy and legal issues of the microfinance sector in a India with specific attention to Maharashtra, based on a review of available literature, web-based materials and information, and the experience of organizations like NABARD, connected with promotion and development of microfinance in the sector. Finally *Five* major partition we have been alienated to present study, namely I] introduction II] Research Methodology III] Micro-Finance in India – An Overview IV] The Policy and Regulatory Framework V] Suggestions for Capacity Building for the Microfinance Sector.

Scope & Limitation of the Study

The scope of the study is limited to the Regulation Policy and legal issues of the microfinance sector in India

The following are the specific limitation of the study:-

1] The study is based upon Secondary data only.

2] The study is limited to few selected aspects of Microfinance i.e. all aspects of Microfinance are not brought under the gamut of this study.

3] Span of collection of data 2008-2010[(4)].

III. MICRO-FINANCE IN INDIA – AN OVERVIEW

Micro finance is the provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi- urban and urban areas for enabling them to raise their income levels and improve their living standards. The beginning of the micro finance movement in India could be traced to the self- help group (SHGs) - bank linkage programme (SBLP) started as a pilot project in 1992 by National Bank for Agricultural and Rural Development (NABARD). This programme not only proved to be very successful but has also emerged as the most popular model of micro finance in India. Other approaches like microfinance delivery through micro finance institutions (MFIs) also emerged subsequently in the country. The MFIs in India are characterized by diverse institutional and legal forms.

Recognizing the potential of micro finance to positively influence the development of the poor, the Reserve Bank, NABARD and SIDBI have taken several initiatives over the years to give a further fillip to the micro finance movement in India.[5]

SHG-Bank Linkage Programme (SBLP) Approach

An SHG is a small homogenous affinity group of about 15 to 20 people who join together to address common issues. Voluntary thrift activities are undertaken on a regular basis by the group and these pooled savings are used to make interest bearing loans to the group members. Apart from inculcating the habit of thrift, the SHG activity also imbibes concepts like financial intermediation and handling of resources. Once the group is stabilized, it gets linked to the banks and avails financial services from banks.

The SBLP has made considerable progress since its inception in the early 1990s, both in terms of the number of SHGs credit linked with banks, as also the bank loans disbursed to SHGs. As per the trend witnessed so far, the commercial banks continued to be the leaders in disbursing loans to SHGs, followed by RRBs and co - operative banks in 2008-09 as well (Table 1).

Table 1.
Agency-wise SHG-Bank Linkage Programme
(as at end-March 2009) (Amount in Rs. crore)

Agency	No. of SHGs (in '000)				Bank Loan Disbursed			
	2007-08		2008-09		2007-08		2008-09	
	Total	Of which under SGSY*	Total	Of which under SGSY*	Total	Of which under SGSY*	Total	Of which under SGSY*
1	2	3	4	5	6	7	8	9
Commercial Banks	735	161	1,005	133	5,404	1,104	8,061	1,102
Regional Rural Banks	328	65	406	82	2,652	598	3,193	655
Co-operative Banks	165	21	199	50	794	156	999	258
Total	1,228	247	1,610	265	8,849	1,858	12,254	2,015

* : Inclusive of 'Swarnjayanti Gram Swarozgar Yojna' (SGSY) and other sponsored schemes.
Note: Totals may not add up due to rounding off.
Source: NABARD.

Under the SBLP, as on March 31, 2009, 4.2 million SHGs had outstanding bank loans of Rs.22,680 crore. The share of commercial banks in total outstanding loans increased from 68 per cent to 71 per cent, with a corresponding decline in the share of regional rural banks and co -operative banks (Table 2).

Table 2
Bank Loans Outstanding under SBLP
(as at end-March 2009) (Amount in Rs. crore)

Agency	No. of SHGs (in '000)				Outstanding Loans			
	2007-08		2008-09		2007-08		2008-09	
	Total	Of which under SGSY*	Total	Of which under SGSY*	Total	Of which under SGSY*	Total	Of which under SGSY*
1	2	3	4	5	6	7	8	9
Commercial Banks	2,378	638	2,831	645	11,475	3,226	16,149	3,961
Regional Rural Banks	876	223	978	259	4,421	1,332	5,224	1,508
Co-operative Banks	371	55	415	73	1,103	259	1,306	392
Total	3,626	917	4,224	977	17,000	4,817	22,680	5,862

* : Inclusive of 'Swarnjayanti Gram Swarozgar Yojna' (SGSY) and other sponsored schemes.
Note: Totals may not add up due to rounding off.
Source: NABARD.

As on March 31, 2009, the number of SHGs maintaining savings bank accounts with the banking sector was 6.1 million with outstanding savings of Rs.5,546 crore. Though commercial banks continued to have the maximum share of the SHG's savings, their share declined from 55 per cent as at end March 2008 to 50 per cent as at end-March 2009. While the share of co - operative banks remained almost same, that of RRBs rose from 31 per cent to 36 per cent during the same period (Table3).

Table 3
Savings of SHGs with Banks
(as at end-March2009) (Amount in Rs. crore)

Agency	No. of SHGs (in '000)				Savings of SHGs			
	2007-08		2008-09		2007-08		2008-09	
	Total	Of which under SGSY*	Total	Of which under SGSY*	Total	Of which under SGSY*	Total	Of which under SGSY*
1	2	3	4	5	6	7	8	9
Commercial Banks	2,811	766	3,550	931	2,078	527	2,773	682
Regional Rural Banks	1,387	357	1,629	434	1,166	211	1,990	775
Co-operative Banks	812	80	943	140	541	72	783	107
Total	5,010	1,203	6,121	1,506	3,785	810	5,546	1,563

* : Inclusive of 'Swarnjayanti Gram Swarozgar Yojna' (SGSY) and other sponsored schemes.
Note: Totals may not add up due to rounding off. Source: NABARD.

The recovery performance of bank loans to SHGs remained at a higher level with recovery rate of 80-94 per cent being the modal class, incase of all the bank groups except the private sector banks. In case of private sector banks, 95 per cent and above was the modal class(Table 4).

Table 4

Recovery Performance of Bank loans to SHG - Agency-wise

(As at end-March 2009) (No of banks)

Category of Bank	Total no. of reporting banks	Recovery Performance of Bank Loans to SHG			
		95 per cent and above	80-94 per cent	50-79 per cent	less than 50 per cent
1	2	3	4	5	6
Public Sector Banks	25		6	12	7
	0 (24.0)	(48.0)	(28.0)	(0.0)	
Private Sector Bank	7		5	1	0
	1 (71.4)	(14.3)	(0.0)(14.3)		
Regional Rural Banks (RRBs)	65		12	31	15
	7 (18.5)	(47.7)	(23.1)	(10.8)	
Cooperative Banks	170		56	58	37
	19 (32.9)	(34.1)	(21.8)	(11.2)	
Total	267		79	102	59
		27 (29.6)	(38.2)	(22.1)	(10.1)

Note: Figures in brackets indicate percentage shares in agency-wise totals. Source: NABARD.

MFI Approach

The emerging role of MFIs as institutions other than banks engaged in providing financial services to the poor is being recognised and the banking sector has been extending loans to MFIs for on-lending to SHGs. During the year 2008-09, bank lo an amounting Rs.3,732 crore was disbursed to 581 MFIs, taking the total loans outstanding to Rs.5,009 crore to 1915 MFIs as on March 31, 2009 (Table 5).

Table 5

Bank Loans Provided to MFIs

(as at end-March) (Amount in Rs. Crore)

Category of Bank by to Banks	Loans disbursed MFIs		Outstanding Bank Loans against MFIs		
			2007-08	2008-09	
1	2	3	4	5	
Commercial Banks	1,969 (1,072)	3,719 (1,762)	2,745	4,978 (497)	(522)
Regional Rural Banks	(24)	2 (153)	13	4 31 (8)	(59)
Co-operative Banks	0.04 (0)	–	0.02	– (13) (0)	(13)

– : nil/ negligible.

Note: 1. Figures in parentheses represent the number of MFIs. 2. The actual number of FIs would be less as some FIs have availed loans from more than one bank.

The microfinance movement has been playing a crucial role in the financial inclusion efforts in the Indian context. Against the backdrop of current global financial crisis however, concerns have been raised internationally about possibilities of surge in non-performing loans, shortage of liquidity and funding, declining profitability and weakness in management and corporate governance[6].

IV. THE POLICY AND REGULATORY FRAMEWORK

Regulation of Micro Finance Institutions

The rapid growth of the micro finance sector and varied number of micro finance providers influencing the lives of millions of clients have necessitated the need for regulating the sector. In India, micro finance is provided by a variety of entities. These include banks (including commercial banks RRBs and co-operative banks), primary agricultural credit societies, SHGs linked to banks and MFIs that include NBFCs, Section 25 companies, trusts and societies as also co-operatives (under MACS). Currently, banks and NBFCs fall under the regulatory purview of the Reserve Bank. Other entities are covered in varying degrees of regulation under the respective State legislations. There is no single regulator for this sector. In this context, for the orderly growth and development of the sector, the Government of India has proposed a legislation and formulated a Micro Financial Sector (Development and Regulation Bill), 2007 which is under consideration of the Parliament. The Bill envisages NABARD to be the regulator and provides that all micro finance organisations desirous of offering thrift services may get registered with NABARD. The legislation, however, is yet to be enacted (Refer Chapter II, para 2.219). In the meantime, formulation of a code of ethics has been formulated by Sa-Dhan in 2007, to be followed by their member micro-finance institutions.

V] SUGGESTIONS FOR CAPACITY BUILDING FOR THE MICROFINANCE SECTOR

Demand Stream: There are three major areas, where these institutions need to focus on.

a) *Support for credit absorption*: To sustain the credit linkages, the support to poor should go beyond the initial loaning of consumption and redemption of old debts to asset creation and enterprise promotion. The success of it depends upon allocation of resources and providing a facilitating environment.

b) *Building Demonstration Centers:* The process of building social capital would be enhanced by exposure to role model SHGs and its federations who have demonstrated good governance, efficiency in functioning and best practices.

c) *Institution Building for Sustainability:* The SHG model has proved to be effective in organizing the poor into institutions and building their social capital. However, the issue of sustainability has still to be addressed. NGOs have formed SHGs Federation, in some cases Resource Centers to provide financial and other associated supports to its member's body. For program sustainability, these federated bodies need to be strengthened.

Supply Stream: Building positive attitude of the bankers is extremely important towards lending to poor and orient them to see lending to poor as a viable proposition and not a social obligation. Other factors, which should focus on are:

a) *Experimentation for field banking:* Many of the formal financial institutions do not have the experience of non-subsidized lending with the poor. As part of building the capacity of these institutions, 10 experimental projects can be initiated for next five years, where each bank will open exclusive micro-finance branches and operate profitably.

b) *Building MFIs:* A cadre of new generation micro-finance leaders needs to be promoted to strengthen the emergence of micro-finance institutions and contribute towards the growth of the sector. Senior executives of the emerging micro-finance institutions need to be provided with varied opportunities to attend the short and long term courses at national and international level in management training institutes of repute.

Enabling Stream:

a) Reallocate subsidies as promotional costs: There is a need to involve NGOs for social mobilization for promotion and building of quality groups. Government should recognize the role of NGOs and collaborate with them in programmes like SGSY as an equal partner. The credit subsidy allocation of SGSY can be reduced and reallocated for promotional costs of NGOs and MFIs.

b) Government to shift from implementation to facilitation: Government departments and agencies are not equipped for undertaking social mobilization processes. In order to encourage promotion of quality SHGs and ensure greater participation of banks the government should play enabling role and not direct implementation role.

c) Collaboration for capacity building: The existing training institutions like SIRD, NIRD and NIPCID need to be equipped to train the government official involved in implementing the SGSY and other developmental programmes. These institutions need to develop collaborations with various strong NGOs and MFIs for field orientation and demonstration for the learners who act as resource institutions.

d) *Networking* : Promotion of networks of NGOs and MFIs need to be encouraged to set standards and provide capacity building support, organize policy workshop, seminars and conferences for dissemination of learning and best practices. Promotion of strong network would facilitate co- learning and promotion self-regulation.

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