THE MICROFINANCE GUARANTEE FOR FINANCIAL INCLUSION: EVIDENCE TO SUPPORT IN INDIA

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ABSTRACT

In this paper ,Finance is one of the useful tools in dispersal of economic opportunities. Timely finance helps both the entrepreneur or producer as well as consumers in raising their welfare position. The increasing gap between demand and supply of financial services has led to bridge a gap between a large number of rural population from formal financial institutions in india . As a response to the failure of formal financial institutions in reaching the poor, the 'micro credit' or more broadly 'microfinance' approach was come and institutionalized in the Indian rural credit system.The main aim was overcome the double problems of formal credit system - non-availability of credits to the poor and bad recovery performance of the existing rural credit institutions. As a result, Microfinance Institutions (MFIs) have come into the rural areas to improve and extend timely, easy and adequate access to financial services. In this context, the present paper discussed the new institutions that emerged in the Indian financial system to include the excluded large number of rural population from formal financial institutions in india. The SHG-bank linkage and MFI models are the two important microfinance approaches in the post-financial reforms in India. The paper also finds that the microfinance sector in India is growing with the origins of new institutions on the one hand and, on the other hand, the NGOs are themselves into financial institutions and entering the business of microfinance. The paper concludes that the suitable laws and regulations to control the microfinance business in India.

***Keywords**:* Microfinance, NGOs, MFIs.

Introduction:

Financial Inclusion is a very important initiative for the sustainable growth of a country. With a huge rural population, that is economically challenged, Government in India has rolled out many initiatives like Rural Employment Guarantee Scheme, Sarva Shiksha Abhiyan Education for All), Bharat Nirman Programme. But to support the growth, a committee on Financial Inclusion (FI) was also formed in June 2006, with Dr. C Rangarajan as Chairman to recommend a strategy to achieve a higher Financial Inclusion in the country. In this paper, we have tried to come up with ways as to how IT can support different collaborative models to implement and sustain the Financial Inclusion initiatives.

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Prime Minister Reviews Financial Inclusion Efforts 20 September 2010 Dr. Manmohan Singh, Prime Minister of India, reviewed the progress towards Financial Inclusion by banks in India was briefed on the efforts being made by banks to reach banking services through information and communication technology based models and banking intermediaries to 73,000 rural habitations having population of over 2000 as per the 2001 census by March, 2012.Chairman, State Bank of India, Shri O.P. Bhatt, and CMD, Punjab National Bank, Shri K.R. Kamath presented through hand-held devices the various technologies of branchless banking being used by them to reach banking services in the rural interiors. These services include deposit, withdrawal, remittance and other facilities. The

Prime Minister also reviewed the safety and security measures put in place for such banking transactions being executed through the business correspondents. Presently, India has about 32000 rural bank branches, and the government in order to facilitate inclusive growth throughout the country has in the Budget Speech 2010-2011 directed banks to extend the reach of financial services to all the villages having a population of more than 2000. This would enable the rural hinterland to become fully connected with the financial sector in India.

Litrature Review:

Review has been done for examining the role of microfinance and financial inclusion for empowering the excluded sections of society to access financial services in India.

Jr., V. Basil Nil Jayasheela, P. T. Dinesha Hans (2008):

The purpose of this paper is to examine microfinance's role in empowering the oft-excluded sections of society to access financial services in India. The authors examine this issue by looking at the different approaches to financial inclusion, including the formal banking, microfinance and SHG sectors. Finally, the authors provide some policy recommendations focusing especially on MFIs' duty to improve their systems, management and governance well before branching into new services such as collecting client savings.

Chakrabarti, Rajesh (2005) [1]Microfinance is gathering momentum to become a major force in India. The self-help group (SHG) model with bank lending to groups of (often) poor women without collateral has become an accepted part of rural finance. The paper discusses the state of SHG-based microfinance in India.

Ghosh, Rajarshi (2005) [2]The article traces the evolution of the Microfinance revolution in India as a powerful tool for poverty alleviation and women empowerment. Where institutional finance failed Microfinance delivered, but the outreach is too small. There is a question mark on the viability of the Microfinance Institutions. There is a need for an all round effort to help develop the fledgling Microfinance Industry while tackling the tradeoff between outreach and sustainability.

Basu, Priya and Srivastava, Pradeep(2005) [3]This paper reviews the current level and pattern of access to finance for India's rural poor and examines some of the key microfinance approaches in India, taking a close look at the most dominant among these, the Self Help Group (SHG) Bank Linkage initiative. It empirically analyzes the success with which SHG Bank Linkage has been able to reach the poor, examines the reasons behind this, and the lessons learned.

Objectives:

The objectives for this paper are as follows:

- To explain the role and importance of financial inclusion in Indian Financial System.
- To analyse the diverse approaches of financial inclusion.
- To examine the role of banking system in expanding banking services for financial inclusion.
- To specify the achievements and problems of SHG microfinance in including the excluded section of the society.

Financial Inclusion:

Financial Inclusion is delivery of basic banking services at an affordable cost to the vast sections of disadvantaged and low income groups. It includes access to formal financial system such as financial institutions, markets and instruments, like savings, loans, remittances and insurance services, at affordable prices. The access to finance for the unbanked is not a new concept for the Indian market. Access to formal banking services has been available through the use of intermediaries such as see the unbanked are those who do not utilize banking services and have limited banking needs. The unbanked are not the poorest of the poor. However, they certainly include those whom banks need to serve but cannot do so profitably in the existing banking environment. Though these consumers need access to banking for savings, loans and microfinance, they do not have bank accounts. The reasons for this are compelling.

1. Lack of steady and substantial income leading to a fear of insufficient funds for an account
2. Limited access to banks, especially in remote areas
3. Lack of formal employment that precludes a financial history
4. Poor financial literacy
5. Psychological factors such as mistrust of financial institutions

This unbanked billion is not outside the banking sector by choice. An important reason for their predicament is that banks do not offer them suitable products tailored to their needs. How to bank the unbanked In China and India only about a third of the population participates in the formal banking sector. In Africa the number is just 25 percent. India has the second-highest number of financially excluded households in the world – 135 million – after China's 263 million. Apart from the obvious requirements of savings, loans, transactions, and investments, the unbanked have certain special needs, which are:

[1] Chakrabarti, Rajesh, The Indian Microfinance Experience - Accomplishments and Challenges. Available at SSRN: http://ssrn.com/abstract=649854

[2] Ghosh, Rajarshi, Microfinance in India: A Critique (May 2005). Available at SSRN: http://ssrn.com/abstract=735243

[3] Basu, Priya and Srivastava, Pradeep , Scaling-Up Microfinance for India's Rural Poor (June 2005). World Bank Policy Research Working Paper No. 3646. Available at SSRN: http://ssrn.com/abstract=757389

- Flexibility in savings and repayment schedules owing to a lack of steady income
- Simplicity and speed in processing
- Small product sizes when it comes to loans and low-balance savings accounts
- Proximity and ease of access
- Basic financial education or information since the unbanked may not understand even elementary concepts of banking

Most banks find it difficult to meet these needs because of the high economic cost of servicing these demands. Some of these measures could include tying up with an NGO or with a retailer and using village residents and empowerment groups as representatives.An estimated 2.6 million self-help groups in India are linked to banks, giving financial institutions access to 40 million households. However, this billion also constitutes an enormous opportunity – if banks are willing to accept the challenge of including them with an eye on the bigger picture. This paper provides a regional perspective to this issue and examines what banks can do to capitalize on this opportunity. If Help Groups (SHGs) and Microfinance Institutions (MFIs).

State Bank of India (SBI), plans to cover 50,000 unbanked villages during 2010-11 as part of financial inclusion drive. The bank plans to hire 15,000 business correspondents, who will help people in the rural areas to open bank accounts. It is not possible for banks to open branches in every village, so a business correspondent and business facilitator model would help in taking banking facilities to every part of the country.Business correspondents are persons who, besides helping rural people to open bank accounts, would facilitate in banking transactions. Their key role is to accept deposits and remit money.

SHGs are usually groups of women who get together and pool their savings and give loans to members. Usually NGOs and National Bank for Agriculture and Rural Development (NABARD) promote and nurture these groups. The recovery experience has been very good from SHGs and there are currently 2.6 million SHGs linked to public sector banks reaching almost 40 million households through its members.

The foreign banks and private sector banks have also accessed the microfinance market by setting up relatively lower cost non-bank companies or by partnering with MFIs to provide small value retail loans or financial services to the relatively higher risk segments of the population. This has been a successful model to reach out, except that the interests are high in the range of 24-30 percent, chiefly due to the high transaction cost for the small sized loans.

India Still Lags in Financial Inclusion:

In spite of all the current initiatives, large population is still financially excluded, unlike in the developed countries where only a small portion of the population needs to be included.Even if one were to consider India's status on Financial Inclusion within the South Asian region, the financial outreach leaves a lot to be desired.Sri Lanka seems to have a better position in the South Asian region. There are some initiatives taken, not only by Sri Lanka, but also in the South Asian region towards Financial Inclusion. By 2005, microfinance institutions covered at least 35 million of some 270 million people in the South Asian region and met around 15% of the overall credit requirements of low income families.

In Sri Lanka, the coverage is particularly high at 60%. The high outreach in Sri Lanka is based on an extensive network of community-based organisations that receive considerable government subsidies. Sri Lanka in particular has been very successful with microfinance reaching out to 63% of the poor families as compared to India's 9%.

Challenges to Financial Inclusion:

There are a number of reasons why Financial Inclusion is not taking place in India. These include coverage, cost of small value transactions, infrastructure, suitable products, flexibility, weak delivery model for community enterprise and financial management support. With the automation of core banking processes and the use of channels such as ATM, IVR based tele-banking, Internet banking, the banking industry has become lean and more profitable. Banks however, face an uphill task in reaching out to the mass customers in remote locations such as villages. Infrastructure cost, operating expenses, security, understanding of customer behaviour and risk associated with it, and low and slow Return-On-Investment (ROI) inhibit banks from expanding into the rural market.

Steps for financial Inclusion:

Today, inclusive growth is a national priority. Much has already been done by banks, non-bank financial institutions, regulators, and the Ministry of Finance to achieve financial inclusion. The steps in favour of financial inclusion has now been reached due to the recent alignment of various policy as well as market factors. The National Payments Corporation of India (NPCI) has been setup to manage the national payments infrastructure. It will deploy an interoperable modern payments, clearing, and settlement infrastructure that can handle large volumes of transactions at very low cost.The regulator has expanded the list of entities that can act as Business Correspondents (BCs). This list, amongothers, includes kirana shops, petrol pumps, self help groups, etc. Thus, banks either by themselves, or along with retail partners such as FMCG firms, MFIs, telcos can appoint kirana shops, self-help groups, and other similar entities as BCs. The regulator prescribes outsourcing guidelines that ensure that there is no conflict of interest when certain banking activities are outsourced .The Finance Minister, in the 2010 budget speech has indicated converting several subsidies into direct cash benefits. The government has created two funds for financial inclusion , which can be instrumental in scaling up financial inclusion efforts in the country. Various benefits programs may even be able to bear part of the capital and operations costs, if an effective micro payments system can be put into place. Thus, the last mile, which is expensive to reach, given the country's large size and geographical diversity, can be serviced effectively. This, combined with the increasing ubiquity of mobile communications, can make branch-less banking a reality. The regulator prescribes guidelines for mobile banking that ensure protection of customer data and customer interests. As a result, crucial parts of the technology infrastructure for micro payments are already falling into place.

The final piece of the micro payments solution is the UID number. Banks can leverage the UID enrollment process and infrastructure to acquire customers and open UID-enabled Bank Accounts (UEBAs). Thus, banks will not have to bear the cost of biometric devices, or pay for enrollment agencies to travel from village to village acquiring customers. The UID-based micro payments model is similar to the familiar online PoS/ATM world that banks are already comfortable with. Using similar ideas and infrastructure dramatically brings down operational costs and risks. The real-time online authentication offered by UIDAI also provides secure identification of branchless banking customers to banks at low cost. The current policy and technology environments, combined with the benefits of using the UID infrastructure as an overlay on the existing banking infrastructure can usher in an era of ubiquitous branch-less banking.

UIDAI to Leverage the Financial Inclusion Programme 11 October 2010 Even as most of the banks didn't show much interest in opening no-frills account for the rural BPL population and the wage earners under the Mahatma Gandhi National Rural Employment Guarantee programme, this attitude of banks might change with UIDAI planning to incentivise them for enrolling the rural poor. Leveraging the financial inclusion programme of the government, the UIDAI will be giving Rs 50 per enrollment to the banks and the Life Insurance Corporation of India- the registrars for collecting demographic and biometric data for the Authority, for registering the rural residents till March 2011. Currently, UIDAI has 17 bank registrars, and soon 10 more banks are likely to be roped in. Interestingly, a rural BPL resident would get a Rs 100 amount for registering for the UID number. Likewise, the banks too would get Rs 100 for each of these enrollments. The banks have been assigned targets for opening up bank branches in villages having population up to 2000. This move is being seen very positively, in line with the Government of India's plan for providing the banking services to 'aam aadmi', under the financial inclusion programme, in all the villages having population up to 2000, by March 2012. At present, there are 600 million bank accounts in the country. However, out of these, only 200-250million accounts are individual accounts, since many people have multiple accounts, which underlines that only 20 percent of the population has access to banking services

Conclusion:

High GDP growth in India, triggered by an open economy has created job opportunities in urban and semi-urban India and it will go further into rural India, increasing the potential for growth to vast sections of disadvantaged and low income groups. Therefore, Financial Inclusion would help in bringing much needed access to the unbanked masses, which are the future growth engine of the economy. While government in India has already set up various initiatives to support FI, they also need to be backed by progressive policies. These can be effectively implemented only through private-public partnerships powered by universal technologies.

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