

Microfinance in Delhi: An Illusion

1. Introduction

Microfinance is defined as the provision of thrift (savings), credit and other financial services to the rural, semi-urban and the urban poor to enable them to create productivity out of the given resources to develop their sustainable livelihood.

The microfinance revolution started with the recognition that poor people needed access to loans and that they could use these funds productively. It has also changed the perception that poor people are not credit-worthy. Records have shown that, instead, they are a good risk, with higher repayment rates than the conventional borrowers. It has been observed that the recovery rate in this sector has been as high as 99.5%.

As per census 2001, about 0.5 to 0.6 million people migrate to Delhi every year from the rural areas in search of better a living and about 1.5 million Delhi poor live below the poverty line.

Microfinance has been able to reach only 10% of the Delhi poor i.e. out of a total of 90 lakhs plus Delhi poor only 9 lakhs have been touched. There has been a huge problem of exclusion. Many of the Delhi slums are untouched with people living in degraded conditions. There can be multiple reasons for it but the vital being the poor support extended by the Delhi Government, unlike the governments in the southern states where micro finance has been a huge success story. Other problems involved are that of high interest capital, less amount of the loan disbursed, the problem of multiple loans, multipurpose borrowings by the poor etc.

2. Models of Microfinance

a. SHG-Bank Linkage Model

Launched by NABARD, under this model the self-help groups (SHGs) are directly financed by the banks viz. commercial banks, regional rural banks, and co-operative banks.

SHGs are groups of 10 to 20 people preferably with the same economic background. These groups may be registered or unregistered.

The loan is given to the group as a whole, which is then further lent to the members within the group. The group members are also liable to save and deposit money with bank under the group's name and the deposited money is later used for internal lending making them self-sufficient. Once the SHG has accumulated savings for about 3 to 4 months, the members may be allowed to avail loans against their savings for emergency consumption and supplementary income generating needs.

b. MFI-Bank Linkage Model

This model covers financing of microfinance institutions (MFIs) by the banks for further lending to the SHGs and other small borrowers.

c. Joint Liability Model

This is a comparatively newer model. These are small groups of about 5 members and many such groups come together at the centre level. Thus as many as 25-30 members are catered to at a time. The meeting is held fortnightly where the money is lent and recovered from the people. The group is also not liable to save unlike the SHGs. The group members here are held liable for each other and thus the liability acts as collateral.

d. Lending to the Individual by Banks or MFIs

In this model the MFIs or the banks give loan to the individuals who are then themselves responsible for the repayment of the loans. This is similar to the conventional methods used by banks to make loans.

Total Number of Groups	716
Number of Members (Approx.)	16000
	Rupees
Total Saving	40,63,926.00
Loan given	26,48,375.00
Total recovery	10,01,844.00
Interest received	82,848.00
Default	11
Bank Account opened	282

Table 1: SHG bank model in Delhi

3. Agents of Microfinance

Informal institutions that take microfinance services as their main activity are called microfinance institutions (MFIs). MFIs are mainly in the private sector.

Microfinance services providers include the apex bodies such as NABARD (National Bank for Agricultural and Rural Development) and SIDBI (Small Industries Development Bank of India).

NABARD is expected to re-finance the rural portfolio of the banks and cooperatives. The other role that NABARD performs is to manage the Rural Infrastructure Development Fund (RIDF). In case the banks are unable to achieve the priority sector lending targets for agriculture, the banks are expected to deposit the shortfall with NABARD under the RIDF. This fund is used by NABARD to fund rural infrastructure projects. While the banks falling short of their targets have been depositing the amounts with NABARD, NABARD has not deployed these funds effectively. NABARD has disbursed only around Rs.13,000 crores out of the total corpus Rs. 23,000 crores available under various phases of RIDF. Therefore the amount that should have rightfully reached the rural economy has not reached them, either directly or indirectly.

NABARD also plays an important role in the facilitation of the SHG-bank linkage programme through their priority sector lending.

At the retail level we have commercial banks, regional rural banks, co-operative banks etc playing a major role.

4. Working of Microfinance Institutions

Microfinance institutions in India can be broadly divided into the following categories:

a. NGO MFIs (Registered Under Societies Registration Act, 1860 or Similar Provincial Acts)

There are approximately 500 NGOs (non-governmental organisations) that have undertaken the task of financial intermediation. Majority of these NGOs are registered as Trust or Society. Many NGOs have also helped SHGs to organize themselves into federations and these federations are registered as trusts or societies. Many of these federations are performing non-financial and financial functions like social and capacity-building activities, facilitate training of SHGs, undertaking internal audit, promoting new groups and some of these federations are engaged in financial intermediation. The NGO MFIs

vary significantly in their size, philosophy and approach. Therefore these NGOs are structurally not the right type of institutions for undertaking financial intermediation activities, as the bye-laws of these institutions are generally restrictive in allowing any commercial operations. These organizations by their charter are non-profit organizations and as a result face several problems in borrowing funds from higher financial institutions. The NGO MFIs, which are large in number, are still outside the purview of any financial regulation.

b. Non-Profit Companies as MFIs (Registered Under Indian Trust Act, 1882 and Section 25 of the Companies Act, 1956)

Many NGOs felt that combining financial intermediation with their core competency activity of social intermediation is not the right path. It was felt that a financial institution including a company setup was better for the purpose of banking. Further, if MFIs are to demonstrate that banking with the poor is indeed profitable and sustainable, it has to function as a distinct institution so that cross-subsidization can be avoided. On account of these factors, NGO MFIs are of late setting up a separate non-profit companies for their microfinance operations. There are around 10 non-profit MFIs operating in the country today.

c. Mutual Benefit MFIs

Several state governments have enacted the Mutually Aided Co-operative Societies (MACS) Act for enabling promotion of self-reliant and vibrant co-operative societies based on thrift and self-help. MACS enjoy the advantages of operational freedom and virtually no interference from government because of the provision in the Act that societies under the Act cannot accept share capital or loan from the state government. Many of the SHG federations, promoted by NGOs and development agencies of the state government have been registered as MACS. Reserve Bank of India, even though it may be providing financial service to its members, does not regulate MACS. There are approximately 250 MACS in the country today providing microfinance services to the poor.

d. For Profit MFIs (Registered Under the Indian Companies Act, 1956 and Reserve Bank of India Act, 1934)

Non-banking financial companies (NBFC) are companies registered under Companies Act, 1956 and regulated by Reserve Bank of India. Earlier, NBFCs were not regulated by RBI but in 1997 it was made obligatory for NBFCs to apply to RBI for a certificate of registration

and for this certificate NBFCs were to have minimum net owned funds of Rs. 25 lakhs and this amount has been gradually increased. RBI introduced a new regulatory framework for those NBFCs who want to accept public deposits. All the NBFCs accepting public deposits are subjected to capital adequacy requirements and prudential norms. Only about 6 MFIs in the country are registered as NBFCs.

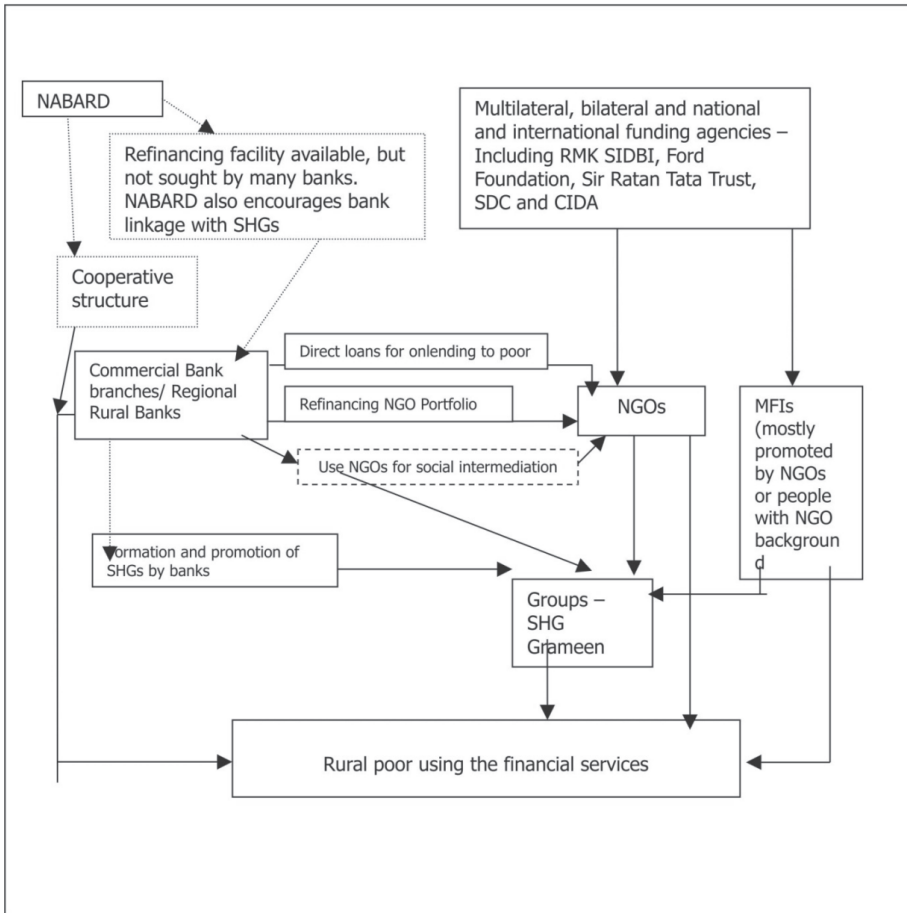


Figure 1: Major players in the microfinance market and their linkages

5. Performance of Microfinance Sector in Delhi

The scenario of microfinance in urban areas in India particularly in Delhi has been poor. Comparing to the large size of poor population in Delhi that needs finances, the availability of capital is low. This is because of the late advent of these institutions here as compared to that in other states particularly in the south. The microfinance activities in Delhi began to start from mid 1990s. This was when the MFIs began

to realise the opportunity for large profits by catering to the urban population. Also the number of MFIs in Delhi is insufficient.

Active MFI players in Delhi as per the last NABARD report include Aajeevika Trust, AIAMED, All India Women's Conference, Asian Society for Entrepreneurship and Development, PRADHAN, DEEPALAYA, Project Concern International India, Society for Promotion of Youth and Masses and SEWA Bharat all of which are registered as societies; CARE India and INDICARE trust which are registered as trusts, Lok Capital Ltd., Satin Creditcare Network Limited, Ujjivan Finance Service Pvt. Ltd and SKS Microfinance Private Ltd which are registered as NBFCs and BASIX which is registered as a section 25 company.

a. Interest Rates

People from different strata of the Indian society are treated differently even in this segment. While the big corporate houses get loans at an interest rate of about 10-14%, those from the marginalised sections get a loan of few thousand rupees at a rate of 30-35%. In a way a poor person has to pay a price for coming out of poverty. One of the reasons for such high interest rates by the MFIs is to incorporate the high administration and transaction costs. Samit Ghosh, CEO Ujjivan, explained this in Dare magazine, "this is because the microfinance is a low margin high volume business. One person is required for processing any loan worth either a few thousand or a few crores. For distributing a loan of Rs. 1 crore in values of Rs. 10,000 each, an MFI, for instance, will need 1000 persons which will push up administration cost. Contrast this to a commercial bank where a single person can distribute loans worth a few lakhs to a several crores."

The breakup of interest rates is as follows:

- Loan cost by the banks is about 11-12%
- Cost of delivery and transaction is about 12-13%
- Added risk of about 1-2%

Hence the overall rate of interest charged by the MFIs becomes as high as 25-28%. However this rate can be reduced by carefully managing the transaction costs. But since MFIs are by far on their own, they are less concerned about reducing the overall costs as these can be incorporated and presented as the higher interest rates charged by them. Hence in certain manner the MFIs make huge profits in the name of priority lending.

b. Multiple Loans

The massive growth of the microfinance sector has led to multiple financing by banks and multiple loans by the clients. This will pose a high risk to the financial institutions. There are two facets to it again.

Since the loans disbursed by the banks are small, the clients, if in need of more money, approach multiple banks to fulfil their credit needs. But they acquire such loans without looking at their ability to repay. Secondly sometimes in order to pay back the loan of one bank people approach another bank for loans and thus ultimately fall into the debt trap. Since the banks do not have unique identity of clients it becomes a challenge to regulate multiple loans. Most MFIs are not regulated and collection of credit information from them may be very difficult.

Another problem from the supplier side is the easy spread of rumours amongst the poor. For example, a person from Nirmaan Bharti, an important MFI working in urban cities, shared that the rumour spreads very easily in context of the bankruptcy of an MFI. Thus people become callous and don't come forward to pay their dues. Thus the process of extracting money from them becomes difficult and costly.

6. Efforts by the Government of Delhi to Support Economically Weaker Groups

a. Department of Women & Child Development

- i. It is planned that there will be generally 10-15 women members in a SHG. Such groups will be assisted in formation through Integrated Child Development Scheme (ICDS) networking and from among beneficiaries of various government programmes like Gender Resource Centres, Stree Shakti Camps, ICDS and other community development schemes. So in order to cover 12 lakh women, there will be 80,000 women self-help groups at the rate of 15 women members in each group. The scheme aims to cover such 80,000 groups over a period of 5 years. Hence in the first year the target will be to assist 16,000 groups or say indirectly 2,40,000 women beneficiaries. The SHGs will be encouraged to undertake community-based training-cum-productive activities in order to create of pool of resources and to supplement their income through profitable activities.

- ii. The Scheme provides for intervention at two stages. The state government will provide a one-time grant to each registered SHG with an initial incentive of Rs. 5,000 towards formation and establishing a group as seed money. This amount will be helpful in procuring some contingencies, in completing modalities/formalities and for requirements of seed money. There will be an initial investment of Rs. 800 lakhs. After the formation of the groups the state government will provide an equal matching grant towards the net savings of such groups as per the norms. It has been estimated that the amount of net savings of such a group will come to Rs. 20,000 annually. The state government's share will be matching equal share of Rs. 20,000 annually. Thus there will be a liability of Rs. 3,200 lakhs spread over a period of one year. There will be a net expenditure of Rs. 40 crores in the first year.
- iii. The Scheme will be implemented through 10 District Offices of the Social Welfare Department. Each district will be thus liable for promoting and assisting 1600 women SHGs. In order to ensure effective implementation of the Scheme, there will be requirements for additional staff and logistics/contingencies at the level of each district as well as at the Department's headquarters. Currently Delhi has about 1800 SHGs in the state while the potential is as huge as 80,000 SHGs.

b. Samajik Suvidha Sangam (SSS)

The Government of Delhi is committed to improving the quality of life of its citizens especially the most vulnerable and disadvantaged sections of the society. For this it has initiated Mission Convergence called Samajik Suvidha Sangam in August 2008 to converge various welfare entitlement schemes and services with the objective of making entitlements reach the poor through a single window system in a hassle free manner. Samajik Suvidha Sangam will be the interface between departments, District Collector's office, Nodal Agencies and NGOs.

i. Objective

The mandate of the Mission is to bring together to a common platform the plethora of schemes to eliminate duplications, error records and strengthen the implementation mechanism by use of IT enabled system, rationalize administration, and incorporate partnerships with civil society organisations for more effective delivery.

ii. Departments

Under the Mission Convergence programme, nine government departments have been involved with their current entitlement schemes. Each participating department has a nodal officer, who is accountable to the department for programme implementation. At the district level, Deputy Commissioner (DC) has been designated as the district in-charge to guide the mission. At the community level the local NGOs have been involved for implementation. The Deputy Commissioner through the help of Mission Convergence provides required secretariat, monitoring and other incidental assistance for smooth implementation of the project. DC will issue necessary instructions to all converging departments through the principal secretaries of the converging participating departments. The participating departments are Health & Family Welfare, Education, Women & Child Development, Social Welfare, Food and Supplies, Labour Welfare, Urban Development, Revenue Department (Divisional Commissioner), SC/ST/OBC/Min Welfare and Information Technology.

iii. Functioning

Samajik Suvidha Kendra would function as a single window service for implementation of 42 different schemes of the above stated nine departments involving an outlay of Rs. 6.5 billion per year.. Under this scheme about 7.5 million low-income group people in the Delhi will get multipurpose cards to avail themselves of various government schemes. The SSS card will be like an all-in-one card. Earlier the poor had to carry several cards for different services but now they will just have to present this card.

7. Recommendations

The basic problem with the government schemes is that they have no accountability in terms of the number of people they have served or in terms of the benefits one has received. This gives rise to the problem of duplication i.e. some people enjoying double benefits whereas many don't receive any support. The Delhi Government should extend financial help through SHGs to implement programmes more effectively. This will help to decentralise implementation of government programmes. For example the scheme for health security or pension to the old can be distributed through the SHGs which will help in creating accountability in the system.

The government must tackle the problem of exclusion by creating a forum in which all the major players in the MFI sector can update the government in terms of the volume of credit disbursed, the areas in Delhi they are catering to or to voice certain problems they face that can be rectified with the help of the government. The government should provide different incentives to the MFIs so that their participation will increase. Incentives can be like the MFI disbursing highest capital to the SHGs or the poor can be given benefits in the form of raised equity share.

Another policy can be to have a card issued by the central information cell to all the beneficiaries seeking financial help from the banks. The central information cell can be a part of the Delhi finance department where all the information of a person seeking financial help from any bank can be recorded in terms of the amount of loan, her background, area of residence, economic status, date of repayment etc. If a person goes to bank 'X' she shall be issued a card from that bank and thus if she wishes to take her second instalment she is required to produce the same card before the bank. This will help to keep a track record of the person in terms of her credit worthiness. This creditor's information is to be maintained electronically and every bank should have access to it.

As we are focusing on disseminating the government schemes through the SHGs they should be unique in identity. One person should not be made a part of two or more groups else the accountability will be diminished. If a person has a unique identity in an SHG group, he shall be issued a card on availing finance from the MFI or the bank and this information should be available to all. This will not only make the system efficient but will also instil a sense of competition amongst the MFIs to cater to as many people as possible. This will also rectify the problem of risk involvement of the MFIs in terms of unstable population.

It is also very necessary that a person has minimal financial literacy required. Even if he is not able to calculate the actual interest rates, he should be made aware of the different schemes of savings available in the banks or the accessibility of different banks in the vicinity. This awareness can be extended through the MFIs as they are more decentralised than any other organisation.

Also minimal or zero savings bank accounts should be initiated for all the poor individuals and not only for the SHGs. The government can play a major role in this. This step would not only create a safe window for them but also help them to multiply their money. The

government can probably come up with their scheme of providing subsidized loans to the banks from nationalized banks if they open up a particular number of accounts in a month .

All in all the government should keep an eye on the MFIs and facilitate their working.

- Prepared by Swati Agarwal
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Endnotes

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A Community Development Officer with one of the Women Self Help Groups

How micro-finance institutions beat nationalized banks

By A. Aiyar Sunday, July 26, 2009

In his Budget speech, the FM hailed bank nationalization as visionary and revolutionary. Yet, nationalized banks have, by and large, not reached the poor. However, micro-finance is now reaching people whom nationalized banks could not.

Households getting micro-credit now outnumber poor households. Outstanding micro-finance loans total 80 million. Some borrowers have multiple loans, so net beneficiaries may total 60 million households. This is more than the 55 million poor households, and more than a quarter of India's 220 million households.

Of course, many poor households are still left out, while non-poor households have got loans. MFIs have yet to reach or saturate large areas in India. But they are spreading fast across most states.

I am a co-promoter of three MFIs: Arohan in Kolkata, Sonata in Allahabad and MIMOZA in Dehra Dun. Within 39 months of existence, Arohan has reached 100,000 poor. The three MFIs together have 2,50,000 borrowers, and within three years should reach one million people. In another three years they may reach one million each. I am astounded that small ventures can scale up so fast.

When launched, these MFIs expected to lose money for four years. But they broke even after two years, because loan defaults were below 0.5% against the expected 2

Once, MFIs started with loans of Rs 3,000 in the first year, going up to Rs 4,000 in the second year, and so on. But now some MFIs start with Rs 10,000, go up to Rs 15,000 in the next year, and so on. They charge around 30% interest. This looks usurious. Moneylenders lend at 50% or more, seize the land of defaulters and make their labourers. MFIs, by contrast, rely on group lending for repayment. If one member of a joint lending group defaults, the others cannot get credit, so they put social pressure on the defaulter to pay up.

Credit card companies charge an annual fee plus interest at around 30%. MFIs, by contrast, give small, unsecured loans, and their interest rates are higher. In both cases, the interest rate reflects the high cost of handling very small loans. Some advocates claim that micro-loans convert poor women into entrepreneurs and greatly reduce poverty. Alas, that's a gross exaggeration. Loans of Rs 5,000 at 30% interest cannot do that.

Micro-finance most cost-effective, efficient way of reducing poverty'

24 Apr 2009, 03:37 hrs IST, KG Narendranath, ET Bureau

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Sam Daley-Harris, Micro-credit Summit Campaign founder

Washington-based Micro-credit Summit Campaign strives to coordinate amongst and give directional inputs to the micro-finance institutions and self-help groups across the world. Micro-credit to the poor is becoming less and less donor-driven. A large part of the micro-finance resources now comes from the savings of self-help groups. Sam Daley-Harris spoke to ET about the usefulness of micro-credit and also the criticism of it in an interview. Excerpts:

How successful has micro-finance been as an anti-poverty formula?

There has been a spectacular growth in the number of micro-finance institutions (MFIs) and their providing succour to the poor in the last few years. In 1997, there were an estimated 618 MFIs, which reached 13.4 million people including 7.6 million of 'the poorest' with current loans. As opposed to this, 2007 saw 3,552 MFIs reaching 154 million people, including 106 million of the poorest.

The growth in the number of the poorest people to get micro credit was therefore 1,300% during the period. Obviously, micro-finance played a major role in reducing poverty although I don't want to claim that micro-finance alone can always reduce poverty. MFIs should find cost-effective ways to measure social progress in order to create a sense of accountability and performance standards. Just as any credible MFI would track its financial health, it should also track the social progress of its clients if poverty reduction is one of its stated objectives.

What matters more is how micro-finance impacts the lives of the poor?

True. The number of clients reached is important, but poverty reduction doubtless matters more.