Need Of Strong Governance Architecture & Structural Interest Rate In Indian Microfinance Industry

Chandan Mohanty, Dr.Suresh Kumar Sahoo , Srinivas Subbarao Pasumarti,

Abstract: Microfinance plays an important role in poverty eradication and now it has become financial inclusion growth Engine. Initial days of microfinance development were aiming towards service to the rural poor people. In the timeframe microfinance became business oriented and focus shifted from service mentality to profit earning mentality. Hence once upon a time this industry was called a tool for sustainable development is now a day's running with many issues for their own stability. Out of many issues two measure issues are still now seeking new path for solution.ie need of strong governance architecture to regulate the microfinance industry and introduction of affordable Structural Interest Rates. Weak governance architecture is fuelling scope for exploitation of Interest rates by microfinance institutions. Eruption of Andhra Pradesh Microfinance Crisis 2010 is a clear example of weak regulatory framework and lack of affordable Structural Interest Rates.

Keyword: Microfinance, Interest rates, Governance and Architecture, Recovery

1. INTRODUCTION

Initial days of microfinance development were aiming towards service to the rural poor people. As time passes microfinance organisations became mature. Performance, competition play important role and slowly micro finance became business oriented and focus shifted from service mentality to profit earning mentality. Hence once upon a time this industry was called a tool for sustainable development is now a day's running with many issues for their own stability. Increase level of acceptance of microfinance has presented two questions i.e. whether increase popularity of microfinance leads to ideal business platform to earn money or still now it has its own strength of power to fight poverty. Present scenario may answer both options are correct. Fact is microfinance helps the Poor to overcome poverty, and it's not through charity. It's a financial mechanism which serve underprivileged low-income group with financial services in an effective way. Unfortunately, in last decade charging high Interest rate, Weak governance architecture, capacity building, and Funding issue has become biggest concern over smooth functioning of microfinance system in India.

2. MICROFINANCE AT A GLANCE

Financial Inclusion is spreading of financial services including payments, savings, credit, insurance at a reasonably affordable rate to all section of the society, most importantly vast sections of disadvantaged and low-income group.

- *Chandan Mohanty, Research Scholar, Faculty of Management Studies*
- *Sri Sri University, Cuttack, Odisha, India Pin 754006*
- *Email:cnmohanty1@gmail.com, Mob No-9861279370*
- *Dr.Suresh Kumar Sahoo , Associate Professor, Faculty of Management Studies*
- *Sri Sri University, Cuttack, Odisha, India pin 754006*
- *Email: sureshsahoofinance@gmail.com, Mobile No: 7978699748*
- *Srinivas Subbarao Pasumarti, Professor & Dean, Faculty of Management StudiesSri Sri University, Cuttack, Odisha, India pin 754006*

This lower income group of developing economies doesn't have proper idea of loan products like cash credit or micro credit. This group of people are largely cut off from Banking/financial system. Government established Regional rural Banks in 1975 to broaden the reach of Credit system of Bank to the rural and under privilege section. Creation of Regional Rural Bank was a milestone in Indian Banking system. Their role was specifically meant for overall development of rural economy. Unfortunately for regional rural Banks loan to rural India customers and its recovery are not smoother any more. It has become a challenge to these RRB's. Due to such default RRB has lost its charm and got affected heavily in terms of mounting NPA's. Failure of credit structure, administrative issues, grave and chronic deficiency in a village communication, financial illiteracy were main reasons for failure of Regional rural Banks in India. Microfinance in 1990 emerged as an alternative institution to traditional Bank lending style. Many developing economies in Asia have reduced poverty by using micro finance scheme as a tool for poverty eradication. Dr Mohammad Yunus from Bangladesh is treated as the pioneer of Microfinance for his tremendous success on lending to poor women in Bangladesh. Following his concept, Microfinance in India has developed with rapid speed in last two decades. However, Microfinance is not smoother any more in India. With increasing issues with suicide, exploitation, forceful lending, the government had to take necessary steps to regulate the industry. Exploitative Microfinance Interest Rates is the beigest worry for the Industry now. Commercialisation of Microfinance organisations are no more serving interest of poor people. Even Mohammad Yunus criticized those microfinance institutions who are behind profit motive. He said poor and uneducated people are not the medium of earning profit by providing micro credit loan. Outbreak of Andhra Pradesh Microfinance Crisis during 2010exposed the working culture of microfinance Institutions (MFIs) in India. (Kaur &Dey2013). Nevertheless, such crisis was an eye opener and milestone in Indian Microfinance system.

3. OBJECTIVE OF THE STUDY

The objective of this study is to find out need of strong governance architecture to regulate microfinance industry in India. The present study is also attempt to analyse the challenges faced by Microfinance borrower's basically low income group and suggestions for socio economic development through small finance banks and Microfinance organisations.

4. RESEARCH METHODOLOGY

The present study is based on certain facts and figures, which are collected from the secondary sources. The secondary data includes Microfinance pulse report of SIDBI & EQUIFAX, RBI circulars, financial inclusion survey of NABARD and other related research articles and conference papers.

5. REVIEW OF LITERATURE

Prabhjot Kaur and Soma Dey (2013) described Indian microfinance history year 2010 was the worst year. Microfinance industry was affected badly because of Microfinance Crisis. Multiple allegations like higher interest charge, multiple borrowing and Unethical mechanism of recovering loans forced borrowers to take suicide attempt. Hence Andhra Pradesh (AP) Government was forced to bring an ordinance as A P Microfinance Institutions (regulation of money lending) Act to protect borrowers. Well they have viewed the Andhra Pradesh regulation act is right on decision, but wrong in its action, area of coverage and implementation. Improper regulation results loss to the industry which is an obstacle to repair. However, they are predicting bright future if any Microfinance bill gets passed it can help to rectify mistake done and act as a damage control learning exercise. Kajal J. Savaliya (2017) has given importance on cope up with financial crisis in India and lack of proper governing authority leads to increase dependence on RBI and NABARD. He had raised concern for microfinance industry as on the bases of whole study. The concern mainly consists of interest rates being charged by institutions to the poor borrower. SIDBI & Access development services 2011in their study recommended increase use of technology, proper risk management, reporting to credit bureau, measurement of portfolio risk on hidden defaults and proper audit control system. Regarding formulation of interest rates they have focused on differential Interest Rates as India consist of various geographical region. Subrata Kumar Mitra 2009 has raised issues on Exploitative Microfinance Interest Rates; while giving justification of commercialisation of microfinance. He had tried to explain how microfinance institutions are loading interest burden on the poor as they are charging higher interest rates. He has advised microfinance institutions to disclose exact productive interest rate to the customers and avoid a "creative" accounting practice which is highly unethical. Microfinance organisations shouldn't forget their main aim of extending helping to the poor and must not aim profit. Dr Prakash Singh2010 after analysing the structure and regulatory framework structure of Micro finance institutions in India identified unethical higher rate of interest being charged, no clarity on interest rates and other charges, multiple lending, collection of security deposit, over borrowing and forceful recovery through coercive method. He has recommended for margin cap of 10% to 12% for MFIs having an outstanding loan portfolio and focused on transparency in interest rates charged. He had recommended for severe action against coercive way of recovering dues by microfinance organisation. Anne pouches 2012 addressed the result of fast development and increased Commercialization of Microfinance industry. He had given importance to proper regulation and strict supervision of microfinance is very much essential in bringing poor to avail financial services. Value of prudentially supervised financial intermediation is more for microfinance organisation from regulation and supervision point of view. Apart from regulation and supervision, regulators must focus on innovation and competition. Islam, porporato & Waweru 2014 mentioned that interest rate structure was always unpleasant for the debate on microfinance industry in the world including Bangladesh. They have strongly recommended for formal regulations for protecting the poor from higher interest rates and other abuses. In Bangladesh Government had incentive in the form of subsidy to Grameen Bank (Leading Micro finance organisation in Bangladesh) to introduce interest rate ceilings for lower interest rate. As a result, Grameen Bank started giving micro credit loan at lower interest rate. The institution incurred loss and these losses were underwritten in the form of subsidies it received. However, this subsidy was not meant for other microfinance organisation. In November 2010 Bangladesh decided to charge 27% interest rate on micro loans.

6. GOVERNANCE ARCHITECTURE ON REGULATION AND SUPERVISION

Regulatory framework determine model for legal organisation, registration, operation guidelines, capitalisation, interest rate structure and takes care of other important aspect. However, Microfinance regulation is still under cloud and not yet understood. Such Weak governance architecture is fuelling scope for exploitation of Interest rates by microfinance institutions. Protection of the country's financial system through microfinance, quality governance to the growth and commercialisation of microfinance industry, protection to the consumer on excessive interest rate, proper structured credit delivery mechanism for microfinance sector, address to financial crisis, dealing with frauds in microfinance sector are issues to be answered when it comes to regulations and supervision part of Micro finance sector in India. In India Reserve Bank of India regulate and supervise commercial Banks under banking regulation Act 1934 where as NBFC's are registered under companies act 1956 and governed under RBI Act. Microfinance institutions are different types of body corporate and legal formats (i.e. non-government organizations (NGOs), nongovernment organizations with profit motive, SHG's, different credit cooperatives and entities with lending practices like group lending, micro credit lending). Question is in how many ways such MFIs with various entities will be regulated! Should microfinance industry run under particular regulatory guidelines set by government or should it be regulated under standardised banking practises. Till date there is no specific authority made for regulating and supervising Micro finance industry. Though during January 2000 RBI prepared a new roadmap for providing microfinance services to NBFC microfinance institutions registered under companies' act 1956. This road map was designed in such way that even if these NBFC's can't take deposit from customers, they will not face any capital or liquidity crunch. Ultimately it reflects lack of liquidity requirement which is a matter of concern if we consider from safety angle. Non-government organisations (NGO's) microfinance organisations main constraint is the ability to mobilise deposit to diversify their fund in the form of Loans. Unfortunately, this step stops them to do as RBI Act particularly mentioned that no incorporated buddies can accept deposit from the public. Banking and microfinance differs from many aspects. Customer Base of microfinance industry is low income group and tiny enterprises that are spread over the nation and often lack behind knowledge on financial services. More over average loan size to microfinance customer is much lower and short time period in comparison with normal bank loans and lending in all cases unsecured (no collateral provided in microfinance loan). Thus challenges are numerous and constitution of microfinance regulatory authority is the need of the hour. Good Governance is also an area where the importance of regulating authority (policy makers) increases for overseeing Microfinance industry. A dedicated regulating authority's governance structure may make exceptional impact on its way of managing risk and credit portfolio. Consumer protection is another area which will be developed after constitution of Microfinance regulating authority since most of the borrowers are illiterate and take loan without any knowledge. They are concerned about sanctioning of Loan for business purpose and repayment i.e. monthly or weekly. They are least bother about rate of interest being charged by these NBFC led microfinance institutions.

7. STRUCTURAL INTEREST RATES FOR MICROFINANCE LENDING

Microfinance institutions are charging exorbitant rates of interest to their customers. Apart from high interest rates they are forcing customers saving, applying flat rate method and adding other service charges which becoming burden on the part of low income customers. While most of their clients are not literate, it helps these microfinance institutions to add illegal charges on these customers. Lack of transparency in interest rate structure is another lacuna found in microfinance institutions and this way they take advantage on illiterate borrowers. As borrowers are more concerned about sanctioning and disbursement of Loan for business development, they ignore interest rates being charged. In 2006, 10 microfinance borrowers committed suicide in Krishna district of AP. Allegations came against microfinance institutions for such suicide attempt. These farmer borrowers were unable to repay loan and because of heavy pressure from microfinance institutions they have committed suicide. These institutions are using different recovery tactics to get their money back from borrowers. They are keeping title deeds of borrowers, threatening through antisocial people and using abusive languages to get their repayment from borrowers. Sometimes they are knowingly adding insurance, saving facilities in the loan facilities which will be helpful in recovery of loans. Such acts are increasing debt pressure to borrowers, poverty and suicide attempts. Borrower complained about "usurious interest rate" being charged by MFIs and using "forced loan recovery" practices for recovery in Krishna district. After enquiry near about 50 branches of MFIs in Krishna district of A P (India) were closed by district administration in March 2006. Though MFI's always denied such allegations as no evidence found against them. Some evidence from studies carried out which indicate these allegations are to some extent true. Places like India where Housing and vehicle Loans are available at 10% or less than 10% Interest rates, microfinance interest rates are always above 22%. These microfinance Loans are taken by poor people to start tiny business with an intention to earn enough money to fulfil their daily basic needs to survive. Charging such higher interest rates is always burden for them. That is why at some point of time microfinance concept now a day's make us feel as exploitation to poor people rather than poverty eradication method. Sometimes people compare it with informal money lending (an old concept of lending system in India) where rural population mostly depends on such informal sector of availing finance at higher interest rates. Before coming to conclusion we have to check both sides of the coin. Every time we can't blame Microfinance institutions. Main reason behind the higher interest rate charged by microfinance institutions also need to be analysed. MFI's borrows from commercial Banks at the rate of 12 percent to 16 percent. High cost expenses comes around 9 to12 percent, provision of 4 to 5 percent they keep for default risk mitigation. 2 percent to 4 percent for supplemental support products like insurance (Sanjay Sinha 2016). Microfinance institutions have higher costs of funds and operation expenses. In Bangladesh where microfinance concept is successful Over 40% of the funds raised through deposits and just 8% from bank loan. But in India scenario is different as RBI Banned Microfinance institutions to Accept deposit from public. Hence borrowing from banks is the only option for capital arrangement. That is why 75% of all MFI funds come from bank borrowing. Similarly operating expenses ratio is more or less 12.5%. Reason behind such expenses is small size Loans and MFIs deliver loan services in the village area and specifically they do doorstep delivery. As most of the microfinance institutions are registered as non-government organisation (NGOs) they are completely dependent on Commercial Banks for funding their own lending activities. Hence steady accesses to capital with fully dependence on commercial Banks are main concern for microfinance institutions. Lack of prudential norms and proper accounting guidelines for microfinance institutions appears with less uniformity becomes a difficult task in front of Bankers.

8. COMPARATIVE ANALYSIS OF LOAN PORTFOLIO

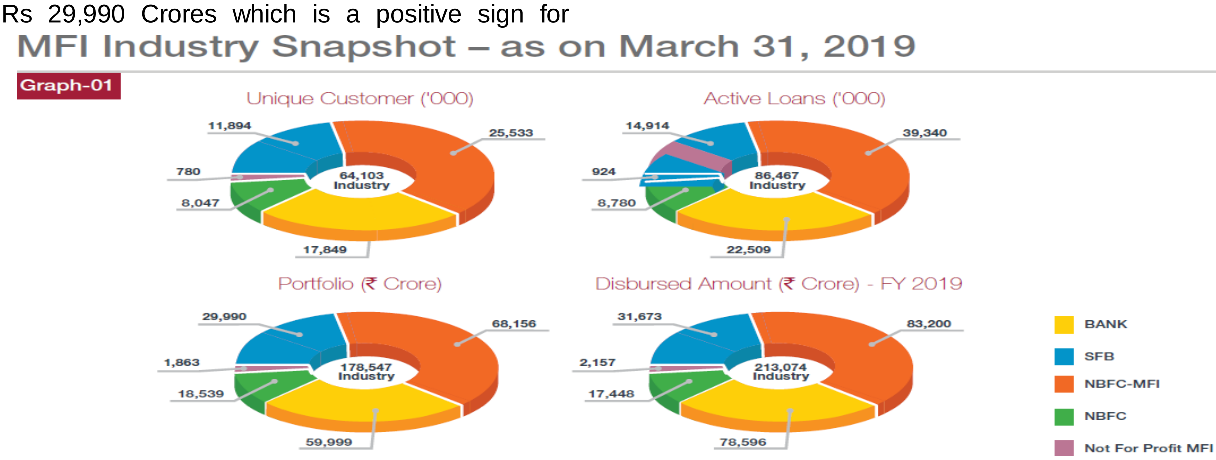
Microfinance institutions have shown tremendous growth in last two decades and expansion of network to new geographic locations. Network expansion increases pressure on process and control and challenges to come up to expectation. While network expansion and business growth has been given importance, risk management aspect has been weakened in last decades. Various expansion plans to new geographies put pressure on proper inside control, Risk and audit function. Interest Rates as per Malegam Committee recommendations the interest rate cap on loans given by MFIs has been fixed at 26 percent. (RBI Circular 2012)

Microfinance Industry Snapshot of March 2019

	Banks	SFBs	NBFC-MFIs	NBFC's	Non-profit MFIs	Total Industry
Unique Live Borrowers ('000)	17,849	11894	25,533	8,047	780	64,103
Active Loans ('000)	22,509	14914	39,340	8,780	924	86,467
Portfolio outstanding Rs in Crore	59,999	29990	68,156	18,539	1,863	1,78,547
Market share in outstanding portfolio (in%)	34	17	38	10	1	100
Disbursed amount Rs in Crore FY 2019	78,596	31,673	83,200	17,448	2,157	2,13,074
Average ticket size in Rupees FY 2019	42,086	30,780	25,850	31,722	29,656	31,623
30+Delinquency	0.50%	1.13%	0.91%	2.73%	0.69%	1.00%
90+ Delinquency	0.22%	0.54%	0.37%	1.35%	0.26%	0.45%

(Source: Microfinance pulse, volume II June 2019 by SIDBI & EQUIFAX)

However, after analysing the above snapshot we found NBFC led microfinance institutions share of loan disbursement is higher than banks, SFBs and NGO Microfinance Organisations. 38% market share belongs to NBFC-MFIs while Non-profits MFIs share is only 1%. It indicates 38% of the Loan portfolio outstanding is being charged 26% or less than that and ultimately poor people are being considered an opportunity as source of profit making. Role of Bank and Small Finance Bank are negligible. Small finance Banks are carrying 17% share of total microfinance Loan outstanding. Within 5 years of opening of small finance banks Loan outstanding has crossed Rs 29,990 Crores which is a positive sign for weaker borrowers of the society. These small finance Banks roles in future will be vital as they can provide Loans to microfinance borrowers at a competitive rate and much below the rate at which NBFC MFIs are providing. Reason for opening of small finance Banks is to provide financial inclusion to sections of the economy not being served by other financial organisations, Such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities. Microfinance industry in India has a total loan portfolio of Rs 1, 78,547 crores outstanding as on 31st March 2019, a substantial growth of near about 40% over last year.



(Source: Microfinance pulse volume II June 2019 by SIDBI & EQUIFAX)

The above graph (Sources Microfinance pulse volume II June 2019 by SIDBI & EQUIFAX) indicates RS 68,156 Crores about 38% of the total Loan portfolio hold by NBFC-Micro finance institutions. It implies larger scope for Microfinance portfolio in India. As on March 2019 Loan disbursement in microfinance grew by 20% in terms of volume while there is a substantial growth of 36% loan disbursed in comparison to 31stMach 2019. In spite of such a large scope in this industry and Loan portfolio of Rs2, 13,074 must leads requirement of a strong autonomous body for regulating and supervising Microfinance industry as a whole. Weak governance Architecture on regulation and supervision was one of the biggest reason of Andhra Pradesh Microfinance Crisis, 2010 where the state government took necessary step after crisis became serious.

CONCLUSION

Microfinance concept was made for the development of underprivileged and poor category citizen. At any circumstance It must not deviate from its aim of extending support to the needy and should not be viewed as an opportunity to make money. Need of governance Architecture on regulation and supervision and interest rate restrictions attempt must be treated as social welfare initiative. RBI must make some structural interest rate mechanism for best means of focusing low-income families to get finance at a low price. Constitution of separate regulating and supervision authority for Microfinance industry can streamline many issues which was a challenge for RBI. Government authorities will also have to estimate the costs of regulation and supervision, including the potential unintended consequences of regulation where innovation and competition should be focused. Mechanism for close supervision on Microfinance organisation is a must as proper framing of microfinance activity can be look after from micro level.

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