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## **A STUDY ON RECENT TRENDS AND PROBLEMS IN USING MICRO FINANCE SERVICES IN INDIA**

**DR.P.ANBUOLI**

**Department of Management Studies  
Visiting Faculty (Full Time)  
Anna University, Regional Centre Madurai**

### **ABSTRACT**

Micro finance refers to the provision of financial services for both credit and deposits that are provided to the people who are living with the poverty. Micro finance provides finance generally to such formal and informal arrangements offering financial services to the poor. Throughout the globe, poor people are excluded from formal financial system like banking, insurance and so on. Difficulty to avail such formal banking service, the poor has adopted a wide variety of informal financial arrangements to meet their financial needs. At present, this difficulty is removed with the establishment of micro finance institutions, but the core objective of providing finance to poor with the ease of formalities is now subject to doubt. In order to check the recent trends and problems in using micro finance services has been analyzed. This study is carried in seven states with 100 respondents. Well designed questionnaire are provided and collected data from the respondents. This study is based on descriptive research design and used secondary data too. This study evidences that the credit disbursement has been decreased from the past three years and at the same time active loan borrower and loan size also decreased significantly. There are several reasons affect the use of micro finance products.

**Key word used:** Micro Finance, Recent Trends, Problems in Micro finance, Micro Finance Institutions, Transformation Effect.

### **1. INTRODUCTION**

Financial inclusion is the main objective of promoting micro finance model in India, the growth of economy largely relies on the health of poor from the both rural and urban. Micro finance aims to provide credit without collateral, usually in small amounts and for short period of time. The exhilaration around microfinance has usually been based on the discernment that it allows formal financial institutions to penetrate into forms of lending that

are otherwise subjugated by informal arrangements, such as customary moneylenders. It is widely recognized that traditional banks, which act as creditors to most entrepreneurial commotion in the modern world, have basically avoided lending to the poor. Instead, credit to the poor segments has been provided generally by local moneylenders, frequently at high interest rates. Poor people are largely deceived from the moneylender clutches, especially, high interest rate, no relaxation on the settlement; stringent norms etc are the big detrimental issues.

During the recent past, micro finance has gone from being hero to zero in the growth discussion: from being praised as the right weapon to solve the problems of development and poverty reduction. There are several criticisms that arise in lending to the poor people. At first, poor often lack the resources needed to invest their borrowings to the productive purposes. Secondly, even if the loans could be allocated for productive purpose, commercial banks would find it difficult to lend. Absence of information about the track record of their business, promoter's capability and creditworthiness are questionable fact in this regard. Finally, showing collateral to cover the loan borrowing is limited or less in the hands of poor borrower. This reduces the bank's recourse to a saleable asset once the borrower defaults on their loan payment. The global surge in keenness for this conception also extended to the active promotion of microfinance as a viable commercial activity to be affianced in for profit. The mushroom growth of micro finance institutions of both non-profit and profit seeking entities was very rapidly followed by crises in many of the same developing countries that were former seen as the most well-known sites of success, in the distinctive manner most financial bubbles that explode. In this study the downfall of microfinance activities in the recent past and various mechanisms that makes microfinance an ineffective tool in rural development has been considered.

## **2. STATEMENT OF THE PROBLEM**

Micro finance is miserably getting downfall due to the problems regarding lack of deployment strategy, institutional support, lack of promptness among the borrowers etc. The phenomenon (Chandasekhar and Jayati Ghosh, 2012) of micro finance group lending, whereby borrowers are clubbed into small groups whose members typically received sequential loans, has been seen as the fundamental innovation that allows micro finance institutions to service clients without collateral, who would otherwise be excluded not only because of the risk of default in general but the cause of the difficulties and high transaction costs involved in sorting more and less reliable borrowers. What this effectively means is that all the costs and risks of the lending process are transferred from lenders to borrowers. So the joint responsibility condition, combined with the sequential payments that function as a sorting mechanism, allows banks to avoid the problem of choosing more risky clients even through the bank remains as ignorant as ever about the safe and risk conditions of borrowers. Proponents argue that this process of voluntary self-selection among borrowers allows price discrimination whereby riskier groups pay higher rates, so that safer borrowers no longer have to bear the burden of riskier ones.

This reduction of cross-subsidization, in turn, implies some reduction in average interest rates. However, this particular route to financial inclusion imposes a heavy cost on borrowers, who are forced directly or indirectly to undertake the supervisory, monitoring and penalizing activities that are usually seen as the responsibility of lenders. For one thing, all borrowers may not want or have the time to engage in these activities. It is observed that the

micro finance activities are mainly offered by formal financial institutions with the help of SHGs. As a result, micro finance programme is growing in those areas where there is incredible growth of formal financial institutions. Micro finance institutions were anticipated to reach those areas where the formal banking system failed to reach and the poor people have to depend on the local financiers. Affordability of loan is uniformly important to the entrance of financial services to the poor people. Fundamentals in the economy urges that every borrower is interest sensitive and the capacity of obtaining loans decreases with the rising interest rates. High interest rate may deteriorate social and economic well being of small and medium sized firms along with marginal poor community.

### **3. LITERATURE REVIEW**

It was well debated that in developing countries both formal and informal financial sectors have failed to serve the poor at required level. While looking on the formal sector, large loans and bureaucratic and long procedures for getting loans keep away the poor from the financial institutions. On the other hand, informal sector is also failed to serve the poor community. Local moneylenders and indigenous bankers are the major part in informal sector and charges very high interest and keep the adult laborer as collateral. Exploitation of real valuation of collaterals high interest rate and monopoly of lenders keep away the majority of the clients from the informal sector of providing finance to poor people, from generation income to reduce poverty. It was highly verified in many studies including Herani (2007); Herani et al. (2007); Herani et al. (2008); Sudan (2007). Lack of provision of financial service and infrastructure in formal and informal services, particularly credit has evolved the micro-credit planning and programs. Micro finance programs can be an effective way to provide low-cost financial services to poor individuals and families. It has been shown to help in the development and growth of the local economy as individuals and families are able to move past subsistence living and increase disposable income (Khandker 2005). Negative impacts of microfinance and microcredit programs are that; microfinance programs benefit the moderately poor more than the destitute, and thus impact can vary by income group (Jonathan & Barbara 2002; Morduch, 1998).

There is a strong tendency to move to the top of the clientele group, and to give little attention to the needs of the poorest, with the end result that their proportion diminishes over time (Navajas et. al 2000). Jayachandra and Naidu (2006) conducted a study on impact of dairy co-operatives on income, employment and creation of assets of marginal and small farmers. Devi et al. (2007) studied the impact of training on women Self Help Groups in Cuddalore district of Tamil Nadu, India. It was found that commercial banks, NGOs and government agencies were had imparted training to the members. The technological training programmes attended by the members of women SHGs resulted in the incremental increase in their employment pattern and asset position. The concept and practice of microfinance sector is increasingly adopting a financial systems approach, either by operating on commercial lines or by systematically reducing reliance on interest rate subsidies and aid agency financial support (Basu et al. 2005).

Woller et al. (1999) surveyed nearly 73 micro finance institutions in the US and developing countries on their impact evaluation. This study revealed that the sample institutions regularly evaluated their programs, monitored project performance and used findings to implement project changes and sought formal feedback from the clients. This finding also discards light on obstruction to performing impact assessment on the role played

by various stakeholders in the evaluation aspect. Kevane et al. (2001) revealed that targeting micro enterprise credit to poor women appears to imply a trade-off between economic growth in favor of poverty reduction and welfare of child. Dunn (2001) finds that program clients' enterprises performed better than non-credit enterprises in terms of profits, fixed assets, and employment. Anderson et al. (2002) revealed that micro finance participation increased environmental awareness and common pool resource stewardship.

#### **4. OBJECTIVES OF THE STUDY**

This study covers and started with the following objectives, these are:

1. To check the recent trends in micro finance activities in India.
2. To know the transformation effect in the offering of micro finance services to the unprivileged sector.
3. To find out the problems in availing micro finance product from the micro finance institutions.
4. To analyze the various reasons behind in the use micro finance products by the micro finance users.

#### **5. RESEARCH METHODOLOGY**

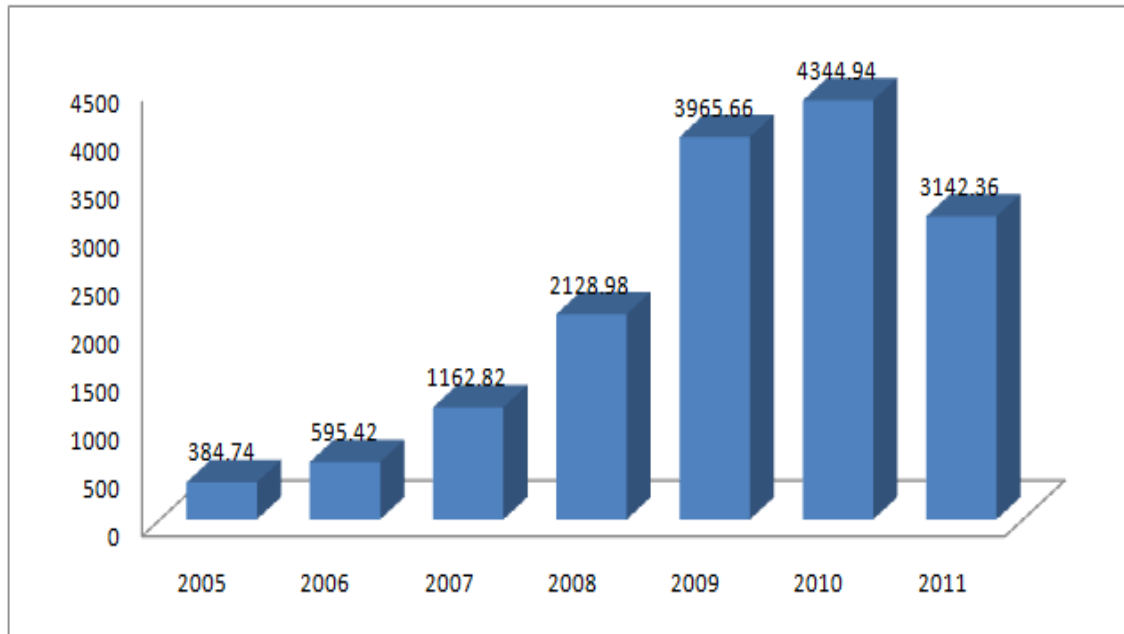
This study is conducted on the basis of 100 micro finance product users and the survey is carried out in 7 states including Kerala, Tamilnadu, Karnataka, Orissa, Andra Pradesh, Maharashtra and Uttra Pradesh. The sample is collected from the countless population of micro finance users. Sampling is conducted by interviewing randomly selected micro finance users over a period of six weeks time, and collected through appointing enumerators. The data is collected using a structured questionnaire; the questionnaire is divided into two sections, the first section deals with problems in getting micro finance products from the micro finance institutions. Second section seeks the reasons behind in the use of micro finance products. The questions are phrased in the form of statements scored on a 5 point summation scale, ranking from 1 for highly dissatisfied, 2 for satisfied, 3 for neutral, 4 for satisfied and 5 for highly satisfied. All the required primary data were collected during the months May 2012 to July 2012, using structured schedules, which were concluded after pre-testing for their sufficiency with an investigation survey of the area of study. In order to analyze the information collected from the respondents', charting techniques, weighted average score, and mean score analysis have been employed to test the worthiness of data collected. In addition to the data collected from respondents, secondary data was collected from various journals, books and websites of micro finance institutions. Descriptive research design has been adopted to frame the study.

#### **6. RESULTS AND DISCUSSIONS**

##### **Recent Trends in Micro Finance Activities**

Micro finance programmes are serving the poor on one side and the same time poor people are feared to avail micro finance on the other side, this is the real case going on the under develop economy like India. During the last three years, growth of micro loans, active borrowers and their size of borrowing are significantly reduced. This scene is not favorable one for the development of poor community. Hence this study makes an attempt to evaluate the recent trends in micro finance activities in India.

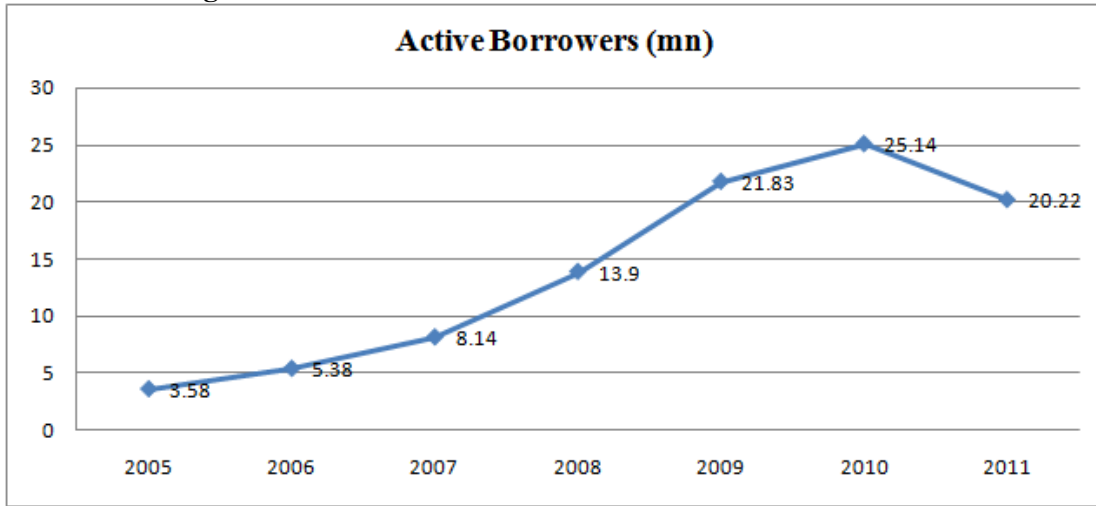
Figure: 1 – Gross loans of Micro Finance Institutions (Amount in million \$)



(Source: The Hindu Business Line, 18<sup>th</sup> September 2012)

The above figure have been prepared with the sample of 26 reasonably large micro finance institutions (Chandasekhar and Jayati Ghosh, 2012) and data collected from the year 2005 to 2011. This sample includes prominent NGOs, leading non-profit companies and profit companies of micro finance. The figure clearly shows the main indicators of micro finance institutions and credit disbursement along with its growth percentage than the previous year. It shows that credit distribution is gradually increasing year after year and peaked in 2010 and thereafter has been coming down. It is clear from the above figure, gross loans distributed in the year 2005 was \$ 384.74 million. In the year 2006, the gross loans distribution had been increased further 55% and reached \$ 595.42 million. The gross loans distribution increased tremendously in the year 2007, there was a increase of 95% than the previous year and gross loan distributed to \$1162.82 million. This was the ever highest growth in the distribution of gross loans from the inception of micro finance activities in the nation. In the year 2008, the credit distributed up to \$2128.98 million and 83% was the increase than its corresponding previous year. In 2009, the credit distribution came to \$3965.66 million and the percentage of growth of gross credit was 86%. The first time since 2005, gross micro credit crossed four thousand levels and reached \$4344.94 million but the growth of gross credit declined tremendously in the year 2010. Growth of credit was just 9.5%, it also shows the maturity status of credit requirement since 2005. Tenderly, the micro credit distribution has declined both in volume and growth percentage in the year 2011. It shows the credit distribution was \$3142.36 million and there was a negative growth of 28% than the corresponding previous year. The number of active borrower in micro finance institutions is depicted in the figure 2.

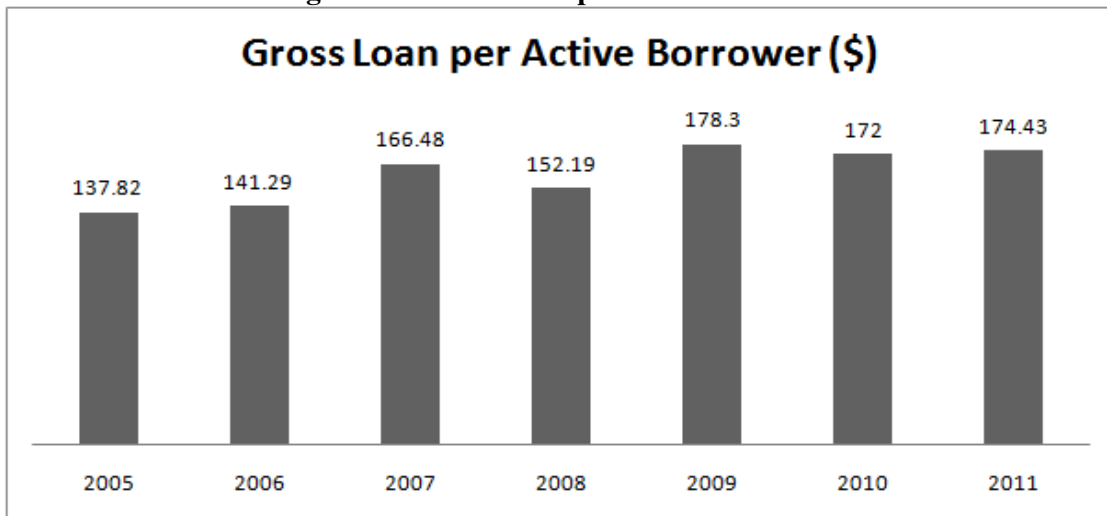
**Figure: 2 – Active Borrowers in Micro Finance Institutions**



(Source: The Hindu Business Line, 18<sup>th</sup> September 2012)

It is evidenced from the figure 2, the active borrowers in the year 2005 was 3.58 million, then the borrower size had been increased to 5.38 million in the year 2006 and showed a growth of 50% than the corresponding previous year. There was a 51% of growth had been resulted in the year 2007, and the number of active borrowers of loan also increased to 8.14 million. The highest growth of loan borrower resulted in 2008; it shows 71% growth and actively 13.9 million borrowers took part in the loan disbursement. In the year 2009, 21.83 million borrowers utilized the loan product, the growth rate declined to 57% than the corresponding previous year. Similarly, in the year 2010 the number of borrowers was in 25.14 million and the growth factor shows just 15% than the previous year. The number of borrower in 2011 was 20.22 million and it deteriorated 20% from its previous level.

**Figure:3 – Gross loans per Active Borrower**



(Source: The Hindu Business Line, 18<sup>th</sup> September 2012)

The gross loan distributed per active borrower is presented in the figure 3, \$137.82 is lowest gross loan in the year 2005 and \$178.3 is highest in the year 2009. The loan disbursement had been decreased in 2008 and 2010 than the previous year performance. In 2011, the loan per active borrower had been increased to 1.4% from the previous level. The gross loan per active borrowers shows increase but that is probably illusory, since many loans that should be written off because of low possibility of being repaid are still being kept on the books.

### **Transformation effect**

Initially micro finance activities were started by NGOs with a view to support the under developed sector in the society. Many NGOs started their activities in the form of offering group lending based on the concept of Self-Help Groups (SHGs). Then the micro finance activities are delivered with the associate help from the commercial banks. Commercial banks were allowed to offer their micro products to the groups with a proven track record of loan repayment. Indian micro finance institutions are prohibited by law from accepting deposits from the public, absence of donations; restrictions to access private investors forced them to take transformation effect. Now the transformation took place from non-profit principle to profit principle. Many of micro finance institutions are transformed into for-profit entities and emerged with for-profit intention. This process was actively assisted by Small Industries Development Bank of India. This was a positive move while considering the point of financial inclusion. But the evil in this model is high interest rates, coercive method of loan collection, unfriendly command, high cost of transaction, hidden costs, penalty, commission, extra charges, lacked response and service and so on. This tendency shows the situation clearly about the moneylenders' and other informal lenders behavior. This trend causes for suffering of micro finance model both on prestige parameter and business viability aspects. The problems with the micro finance model is the poor segment took on multiple loans from different sources with the intention of settling previous loans availed from another micro finance company. In addition to this painstaking situation, intermediaries like politicians and head of associations. They use credit for the development their own welfare rather the theme of micro finance. Such intermediaries exercise undue influence on the borrowers and micro finance institutions in the conduction micro finance business.

### **Problems in availing Micro Finance**

There is different micro finance models are providing micro finance to the underprivileged community in both rural and urban. All the models are not exclusively focusing on those who are below the poverty line. Micro finance is spreading rapidly in all the areas but with a slow progress in targeting the people for serving with available micro finance products. Lack of specific framework for arranging micro finance users in one line, lack of standardized system, communication gap are the big troubles in deploying micro finance products. In addition to that microfinance institutions are also biased while offering service to the required micro finance credit. In order to run the groups successively and to achieve higher repayment rates, they generally select the non-poor people as their beneficiaries. This is contradicting the objective of micro finance institutions. Despite this contradiction, now micro finance institutions are continuously adopting the same exercise. Hence this present study seeks the factors behind in the use of micro finance by the micro finance users.

**Table – 1: Problems in availing Micro Finance**

<b>S. No</b>	<b>Factors</b>	<b>Weighted Mean Score</b>
1.	Charges more interest on loans	4.12
2.	Use of undue influence in case of delay in loan settlement	4.34
3.	Unnecessary delay caused in availing service	3.89
4.	Documentary support expected for credit	3.75
5.	Low interest for micro savings	4.01
6.	Micro insurance is not suitable to cover survival	3.78
7.	Charges are very high	3.98
8.	Officials support is not satisfactory	4.21
9.	No involvement on provision of micro finance service	3.57
10.	No chance for getting business and technical support	3.82
11.	Lack of finance support for starting business	3.92
12.	No subsidy offered at worse times	3.99
13.	Failed to support livelihood	3.43
14.	Consumes more productive hours	3.73

**(Source: Primary Data)**

It is clear from the above table-1, micro finance users are facing several problems in availing micro finance, and descriptive statistics shows the details regarding problems in availing micro finance. Different problems of availing micro finance is identified with the help of suitable survey instrument, and the data is collected by five point rating scale ranging from strongly agree to strongly disagree. From the list of 14 problems use of undue influence in case of delay in loan settlement are highest problems while getting loan from the micro finance institutions. Followed by officials support is not satisfactory on the use of micro finance product. Similarly, high interest on loans, low interest on micro savings are equally affects the use of micro finance products. No financial subsidy offered at worse times, very high processing charges, and lack of finance support for starting business. Unnecessary delay in availing services is the next important problems facing by the micro finance users. The remaining factors like, documentary support expected for credit, not suitability of micro insurance, no involvement, failed support livelihood and consumes more productive hours while using micro finance services are modest affecting factors on the use of micro finance products.

#### **Reasons behind in the use micro finance products**

Micro finance is designed to meet various requirements of its users; like micro credit, micro savings, micro insurance, micro leasing and money transfer. Micro finance users are availing such finance schemes to develop their position to attain better livelihood. Now this study seeks if there is any chance prevailing to assist the reasons behind in the use of micro finance products by the micro finance users. The data is collected through five point scale and



if the mean score is falls more than 4.0 it is taken as high importance, if it relies from 3.0 to 3.99 it is assumed as medium importance, if the score falls less than 3.0 it is taken as low importance. Accordingly the respondents expectations are analyzed with the help of mean score analysis.

**Table: 2 – Reasons behind in the use micro finance products**

<b>Reasons</b>	<b>Mean</b>	<b>Std. Deviation</b>	<b>Rank</b>	<b>Importance</b>
Starting own business and its development	4.21	0.87	2	High
Future planning and protection from evils	3.83	0.94	4	Medium
Construction of own house	3.56	1.01	7	Medium
Family function	3.60	1.12	6	Medium
To discharge basis needs	3.48	1.01	8	Medium
Education to children	4.25	0.93	1	High
Wealth creation purpose	2.11	1.13	10	Low
To acquire land or assets	3.43	1.01	9	Medium
Medical expenses	3.76	1.23	5	Medium
Unexpected happenings	3.93	1.42	3	Medium

**Source: Primary Data**

It is clear from the table-2; there are several motives behind in the use of micro finance products like micro credit, micro savings, micro insurance, micro leasing and micro money transfer. The highest motive of the micro finance users are the finance to education purpose of their children. Followed that starting own business and its development is next important motive of the micro finance users. Both factors are getting the high importance and ranked as first and second respectively. Then future planning and protection from evils, construction of own house, family function, to discharge basis needs, to acquire land or assets, medical expenses and unexpected happenings are the medium importance factors to the micro finance uses. They are using micro finance products on these occasions without any discrimination. Wealth creation purpose is low importance factor to the micro finance users, they rarely uses micro finance products for such purposes.

## **7. CONCLUSION**

Micro finance programme has witnessed noteworthy growth in India during the first decade of 21<sup>st</sup> century. Various evidences found that these activities are assisting the poor in many ways. But in the past three years, there were many structural and functional changes have created many complexions and caused for poor growth in the loan disbursement. In addition to that, the focus of micro finance institutions has continued on expanding the outreach of micro finance programme with little attention on the depth, quality and viability of the financial services. Besides eliminating these problems there is many thing which can be done in this field to make micro finance more effective. In this study, the progress of micro finance lending has been measured with three parameters like loan disbursement and

its growth, active loan borrower, and size of loan amount borrowed. This trend shows that the reach of micro finance has been saturated because the transformation effect. Many of micro finance companies are transformed from non-profit to profit entities. This transformation may offer quality service with increased service avenues but it is not poor-friendly method to safeguard the interest of poor in the rural and urban. It may give another meaning in terms of violating the objective of establishing and providing micro finance service to the poor.

Micro finance activities fulfill the different needs of poor community in terms of offering micro credit for both personal and business loans, micro savings to ensure better future planning, micro insurance for life protection, micro leasing for developing business and micro money transfer for facilitating transfer of payment from one place to another place. Despite this scenario, micro finance users have to face several problems while accessing service from the micro finance institutions. Charging more interest on loans, low interest on savings, undue influence, unnecessary delay, documentary support, insufficiency of micro insurance, high charges, lack of officials support, no subsidy, etc. are the problems in the availing micro finance services. Micro finance users are availing this services while starting own business, future planning, house construction, family function, basic needs, education of child, acquisition of land, medical expenses and unexpected happenings. Hence taking adequate steps to bridge gap between micro finance institutions and micro finance user can remain a powerful tool for development.

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