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MICROFINANCE, FINANCIAL INCLUSION AND SOCIAL IMPACT IN ANDHRA PRADESH

Dr. N. A. Francis Xavier*, Fr. N. Bujji Babu, SJ** & Fr. S. Melchior, SJ***

Abstract
The microfinance sector has undergone a qualitative as well as quantitative sector and is now a business. It services about 77 million clients and by one estimate, they are stated to have disbursed nearly US$20 billion. It is widely perceived that the sector is a critical element in the expanding financial inclusion and it was widely hoped that the sector would rescue the poor from the clutches of the private moneylenders. This assumption by policy makers led to their being granted various exclusive privileges. However, over the past few years, the sector has undergone a qualitative change with a number of MFIs deciding to become companies. This paper argues that the listing of SKS Microfinance on the stock exchanges after a widely successful IPO is the beginning of a trend that would actually create more problems for the poor. The paper argues that while a well-regulated microfinance sector in the social sector leads to greater financial inclusion, the present state of the industry would actually lead to greater exclusion and that the present crisis in the sector is only a natural corollary. The paper calls for a fundamental altering of the business dynamics of the sector and argues that the present nature and dynamics of the business have failed in expanding financial inclusion. It argues that the banks may actually be better off in the long-term by seeking an alternative channel that would take up credit delivery those at the 'bottom of the pyramid' by keeping their long-term interests in mind rather than using the microfinance channel to meet their regulatory targets related to lending.

Microfinance & Financial Inclusion

Financial Inclusion has become the new buzzword in the corridors of power. Policy makers and members of the academia have offered a number of solutions that supposedly expand financial inclusion through a variety of methods. Microfinance has been marketed as one of the panacea for the ills that plague the Indian economy, especially when it comes to delivering credit to the poorest of the poor. It has become common amongst even the business world to call for an expansion of the market to those at the 'bottom of the pyramid'.[1] A number of governmental initiatives including the most recent the Unique Identification Number (UID) are expected to herald changes that would expand the market to the 'bottom billion'.

* *Head, Department of Commerce, Andhra Loyola College, Vijayawada,. Email id: nafrancisxavier@gmail.com*
** *Lecturer, Department of Commerce, Andhra Loyola College, Vijayawada*
** *Lecturer, Department of Business Administration, Andhra Loyola College, Vijayawada*

[1] *A term popularized by C.K.Prahalad.*

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Over the past decade we have witnessed a number of innovations in the financial sphere at the global as well as the national level. The recent global financial crisis only highly the problems of financial engineering run amok. India is not far behind, though the scale of financial innovation and financial engineering has been rather muted, thanks largely due to the proactive conservatism on the part of the Reserve Bank of India. One important group of financial players who have grown exponentially over the past decade are the microfinance companies. It is now estimated that the microfinance sector is now estimated at approximately Rs.30,000 crores.

As a generalization, financial inclusion is stated include an attempt to expand the delivery of financial services to the poor at an affordable cost. By way of financial services it meant to include credit, savings, insurance as well as various payment services.[2] This financial inclusion has become imperative if the benefits of economic growth are to reach all stakeholders. NABARD Report has cited NSSO data which shows that reveals that nearly 51.4% of total households in the country donot have access to credit either from institutional or non-institutional sources, while only 27% of the total farm households are indebted to formal sources. In some parts of India the figure is as high as 96%.[3] It is in this context that it was widely expected that the rise of the microfinance sector would expand financial inclusion by delivering credit to the poorest of the poor, especially those in the 600,000 villages of India. However, The microfinance sector has been in the news for all the wrong reasons in Andhra Pradesh.

Since 2005, the microfinance sector has emerged as nothing more than a corporatized version of a moneylender only that it has a professional administrative and management structure. In 2005, a number of MFIs decided that they would be more profitable if they converted their business model to one that would be more akin to the Non-banking financial companies (NBFCs) rather one that would be dependent on the self help groups. This led a number of them to be become 'for-profit' companies. The most recent trend that has been inaugurated is one of such MFIs drawing the support of global private equity groups (Share-Microfin and SKS among others) and even going in for Initial Public Offerings (IPOs). Such rampant profiteering has led to most of the MFIs to conveniently forego the social up-liftment goals and concentrate on profitability.

This change is clearly visible in the nature of present day microfinance activities. NABARD guidelines (which were subsequently reiterated by the RBI[4]) had recommended that the following criteria should be broadly based on Self Help Group (SHGs) where:

[2] *http://www.nabard.org/pdf/report_financial/Full%20Report.pdf*
[3] *http://www.nabard.org/pdf/report_financial/Full%20Report.pdf*
[4] *http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/40MCMC010709_F.pdf*

(a) The Group should be in existence for at least six months.

(b) The Group should have actively promoted the savings habit.

(c) Groups could be formal (registered) or informal (unregistered)

(d) Membership of the group could be between 10-25 persons.

MFIs have not taken sufficient measures that would enable them to follow the letter and spirit of at least the first two criteria. Instead they have been involved in a process that has actually pushed credit to those at the bottom of the pyramid. While they claim that they have replaced the moneylenders, other research indicates that they have become an additional source of credit in some places, thereby adding to the indebtedness of the borrowers rather than helping them. This aspect of the MFIs has not been given sufficient attention. This pushing credit has largely become a characteristic feature of the MFIs due to their 'for-profit' nature and due to their interest in attracting equity investors. It is pertinent to note that equity investors are always interested in expanding their profitability. In addition to this, listing on the stock exchanges (like SKS Microfinance Limited) means that quarterly profits are the hallmark of these companies. This has led to greater pressure on Microfinance companies as there is a constant pressure to increase their profits.

The pressure brought about by the MFIs when collecting their loans has led to a spate of suicides (some estimates place the number of suicides at about 75). These activities of the Microfinance firms have forced the Government of Andhra Pradesh to pass the "Andhra Pradesh Micro Finance Institutions (regulation of money lending) Ordinance,[5] 2010", (herein referred to as "AP Ordinance"). Even the former Governor of the Reserve Bank of India has pointed out that the MFIs are no better than moneylenders.[6]

The recent problems in Andhra Pradesh have highlighted a number of structural flaws in the nature of the microfinance business. It is imperative to point out that while a large part of the public scrutiny has been confined to the high interest rates and the violent methods used to collect loans, it is imperative to point out that what is commonly referred to as the the microfinance business is more of microcredit business with a number of MFIs not laying sufficient emphasis on insurance and the savings aspects.

A Reserve Bank of India (RBI) report in 2009 pointed out that:

(a) Some MFIs were focusing on relatively better banked areas

(b) "Competing MFIs were operating in the same area, and trying to reach out to the same set of poor, resulting in multiple lending and overburdening of rural households" (p.8)

(c) Many MFIs supported by banks were not engaging themselves in capacity building and empowerment of the groups to the desired extent. The MFIs were disbursing loans to the newly formed groups within 10-15 days of their formation, in contrast to the practice

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[5] *For an exhaustive analysis of various clauses and its possible impact on the microfinance sector see, "Is Pressure from Below Working?: Government Reaction to the Micro-finance Crisis", 24 October 2010 in http://bubbleomania.blogspot.com (Blog Last visited on 25 November 2010).*

[6] *http://www.financialexpress.com/news/mfis-no-better-than-money-lenders-yvr/714506*

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obtaining in the SHG - Bank linkage programme which takes about 6-7 months for group formation / nurturing / handholding. As a result, cohesiveness and a sense of purpose were not being built up in the groups formed by these MFIs (p.9).[7]

It is therefore sufficiently clear that the nature of evolution of the MFI business over the past five years (especially since 2005) has meant that there is little scope for MFIs to serve their originally stated objective of serving the poor. The history of capitalism is such that till date it is almost unknown that a listed company has served an essentially social purpose rather than a goal to primarily enrich their shareholders.

This inability of the microfinance institutions to fulfill their stated aim of financial inclusion is all the more worrisome as the growth of the MFI business has largely been aided by the banking sector. This is because Reserve Bank of India (RBI) guidelines that state that lending to the MFIs can be accounted as priority sector lending in their books.[8] The ostensible reasoning for priority sector lending benefits arises from the view that bank lending to the MFIs and their onward lending would lead to better credit delivery to the poor thereby expanding the scope of financial lending. It has been pointed out that Andhra Pradesh accounts for nearly 35 percent of the microfinance lending in India. The exposure of the banks to the Microfinance companies is estimated at nearly Rs.10,000 crores, while other estimates place it at nearly two or even three times that amount. The major banks which have an exposure to the sector in India are: Axis Bank (about Rs.1,000 crores), Bank of Baroda (Rs.300 crores), HDFC Bank (Rs.1,200 crores), ICICI Bank (Rs.2,500 crores), Punjab National Bank (Rs.1,000 crores), State Bank of India (Rs.1,000 crores) and YES Bank (Rs.700-900 crores). Andhra Bank is rumoured to have a large exposure, though the bank is yet to officially announce its exposure. The detailed exposure of the banks have not been officially announced, and the RBI has only recently asked banks to provide details about this exposure. The State Bank of India is an exception and it has stated that it has about Rs.300 crores of exposure to the sector in Andhra Pradesh. It has been pointed out that MFIs raise nearly 75-80 percent of their funding requirements from the banks, about 15 percent from equity investors and another 10 percent from other sources.[9]

The post 2011 AP developments and the increased push to expand financial inclusion (now Pradhan Mantri Jan Dhan Yojana) means that the near future may witness a paradigm shift in the manner the bottom of the pyramid is approached. Various studies (Ananth and Oncu 2013,2014) indicates that the BC model has had varied results but is a positive development. The reach of Jan Dhan accounts offers an opportunity to make these accounts the basis around which a larger network that links users to small businesses – many which already access the formal banking system. Aadhaar enabled micro-ATMs (BC outlets) offer an opportunity to use Rupay cards validated by biometrics to pay for purchases

http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/40MCMC010709_F.pdf
For a further discussion on the microfinance sector see the blog: http://bubbleomania.blogspot.com for a number of posts on the development of the crisis in Andhra Pradesh and for various options.
Business Standard, Section II, 19 November 2010.

replacing cash. However, this requires certain pre-conditions to be fulfilled. Importantly, it will require the banks to create a system that will enable transfer of money almost instantaneously – not a problem if each Rupay Card is provided with an inbuilt Immediate Payment Service (IMPS) registration and Near Field Communications (NFC) tags. Such a digital ecosystem has the ability to facilitate a society where electronic transactions can replace cash. Technological advances and the spread of mobile phone offer grounds for optimism for a country like India with its large population of illiterate citizens. One such technological advance is the recent grant of a Patent by US for Samsung that offers contactless fingerprint authentication using a positive match with a valid fingerprint image store in a phone memory.

The BC model has witnessed rapid adoption among the community, especially when it works effectively, indicative of the large unmet demand for formal financial services. The three immediate benefits more clearly discernible in the under-banked areas include convenience, lower transactions costs and improved banking relationship visible in the form of higher loan recovery rates. The net impact of the spread of banking, though largely not quantified, is that it has reduced the cost of various services that were provided in the past by informal service providers.

Singh, Dadhich and Ananth (2015) opine that the success of Jan Dhan is not assured. On the contrary, its ultimate success will be indicated only when the formal banking system eliminates private, informal moneylenders. Two major issues that presently constrain the benefits of PMJDY reaching their intended beneficiaries quickly include lack of access points and transaction limits on accounts opened through BCs (Ananth and Oncu 2014, Dadhich 2014). They opine that the lack of access points means that effectively half of India's villages lack banking access and the need to remove the transaction limits placed on PMJDY accounts are necessary to make them PMJDY a success.

Financial inclusion is expected to make significant changes in the economy, especially the rural economy, which is expected to witness a revolution in availability of financial instruments mainly because of– PMJDY, gold monetization scheme and MUDRA.The DBT which will operate through the banking system will also ensure regularity of flow of liquidity in households and therefore opportunities for investment. The key player in the market would be banks, micro-finance institutions, self-help groups, post offices and MUDRA bank. The banking system which mainly will be the conduit to the flow of resources can be expected to offer more financial instruments to retain and park these funds within the system. The most important social impact is that it will enable millions of poor to access the formal banking sector – a dream that has not been fulfilled despite various policy interventions since independence.

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