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Requirement of Regulations on Micro Finance Institutions - An Experience of Karnataka State, India

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Abstract

The micro finance industry in India has had a tremendous growth over the last three decades in terms of accepting deposits, loan facility, insurance cover and other services to the people who are at the bottom of the pyramid. The kind of services offered by the institutions has positively brought changes to the lives of these needy people. The aspirations of the rural poor in India is supressed for a long period of time and their wait for helping hand has been curtailed by the micro finance institutions which are generously ready to fulfil their dreams. The efforts of these institutions in this direction is widely appreciated by the governments and the beneficiaries across the globe.The industry will grow to meet the needs of underprivileged which will offer a life of dignity and follow up of regulatory frameworks as part of MFI governance by the institutions will ensure the delivery of service with humanity.

Keywords: Micro finance; Government; Beneficiaries; Under privileged; MFI governance

Introduction

The micro finance industry in India has had a tremendous growth over the last three decades in terms of accepting deposits, loan facility, insurance cover and other services to the people who are at the bottom of the pyramid. The kind of services offered by the institutions has positively brought changes to the lives of these needy people. The aspirations of the rural poor in India is supressed for a long period of time and their wait for helping hand has been curtailed by the micro finance institutions which are generously ready to fulfil their dreams. The efforts of these institutions in this direction is widely appreciated by the governments and the beneficiaries across the globe. There are two dimensions to the present situation of microfinance services in India. The first one is the increased volume of microfinance services to the poor in India and the other is increased unethical practices of these institutions creating an atmosphere of fear, helplessness and burden of repayment reminders among the beneficiaries as it is the case among commercial financial institutions.

The need for strengthening the micro finance services to the poor with the spirit of uplifting them from poverty and ensuring equality for all is the need of the hour. It is also important to see that the institutions are also capable of generating working capital with a view to survive but not at the cost of business ethics. In order to make this happen, it is vital to implement the governance norms or instilling effective regulatory frameworks for micro finance institutions so as to build a positive environment for the people who are in need of this service. The industry will grow to meet the needs of underprivileged which will offer a life of dignity and follow up of regulatory frameworks by the institutions will ensure the delivery of service with humanity.

Regulations of MFIS in India

Regulations on MFIs is very much essential as the shift in focus of these institutions is deviating from the one for which they were established few decades ago. Considering the importance of microfinance institutions in fulfilling the goals of financial inclusion, it is essential to understand the body of laws, rules and regulations which govern this financial tool. Following the aftermath of the Andhra Pradesh microfinance issue and the subsequent rise of the microfinance industry nevertheless, various prudential and non-prudential norms were evolved by the regulatory bodies in the country in order to effectively regulate microfinance institutions. However, an overlap between the areas dealt with by various authorities governing microfinance entities on critical issues like interest rate determination create uncertainty on the basic conditions of thriving in this sector for participant institutions.

The Figure 1 will further enhance the importance of regulations on MFIs in India. It is in this back drop it becomes necessary to study the changing role of MFIs and the requirement of regulations to monitor the wrong doings of these institutions and developing faith among the borrowers towards the service and ensuring the institutions behave more responsibly with clear conviction of their role and purpose for which they are established. The present study is to ascertain the level of governance norms adhered by the institutions and the need for increased regulations to foresee the growth of MFIs towards offering better livelihood to the needy where profit is not the lone agenda of the MFIs.

Literature Review

Microfinance supports mainly informal activities that often have a low return and low market demand [1]. It may therefore be hypothesized that the aggregate poverty impact of microfinance is modest or even non-existent. If true, the poverty impact of microfinance observed at the participant level represents either income redistribution or short-run income generation from the microfinance intervention.

The article writes that, about one billion people globally live in households with per capita incomes of under one dollar per day [2]. The policymakers and practitioners who have been trying to improve the lives of that billion face an uphill battle. Reports of bureaucratic

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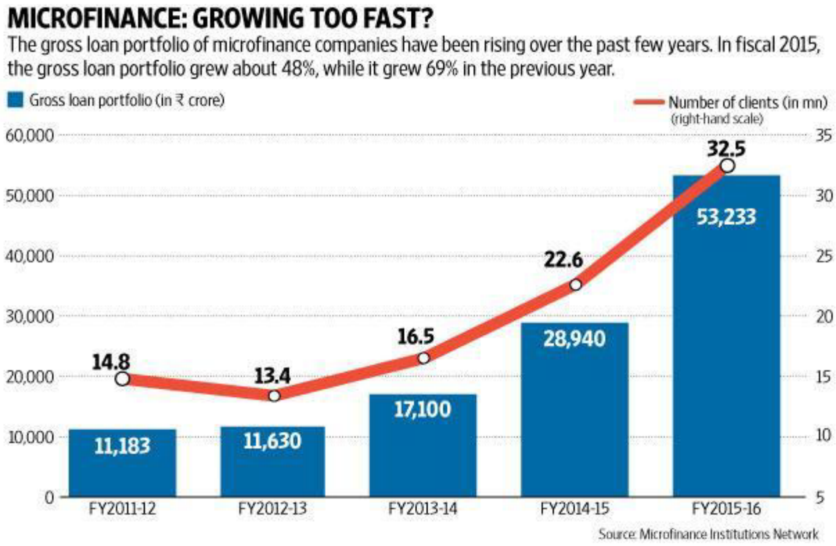

Figure 1: The importance of regulations on MFIs in India.

sprawl and unchecked corruption abound. And many now believe that government assistance to the poor often creates dependency and disincentives that make matters worse, not better. Moreover, despite decades of aid, communities and families appear to be increasingly fractured, offering a fragile foundation on which to build.

Highlights that, micro debt can create considerable opportunities for people to utilize 'lumps' of money so that they can improve incomes and reduce vulnerability [3]. But not all micro debt produces favourable results, especially for poor people working in low-return activities in saturated markets that are poorly developed and where environmental and economic shocks are common. Because of circumstances beyond their control (sickness, flood, drought, theft and so on), lack of skills and knowledge or taking bad decisions, a proportion of poor borrowers encounter great difficulties in repaying loans. While MFIs suggest that such problems are overcome through 'social support' in some painless way this is often not the case— talk to the dropouts of MFIs!

It has been arguing that, microfinance was initially regarded as a purely not-for-profit endeavour undertaken mainly by NGOs and reliant on donations for financing [4]. Microfinance NGOs departed from traditional NGOs in claiming that lending to the poor could be managed as a self-sustaining endeavour by charging interest rates sufficiently high to cover the cost of lending, and in insisting on loan repayment, which was previously largely not required of the poor, though considered desirable.

Ten years ago most Indian MFIs operated as nongovernment organizations (NGOs) focused on adapting the group-lending model from Bangladesh [5]. At that time a few NGO MFIs began to transform to nonbank finance companies (NBFCs) in order to tap equity investment. This shift in legal form enabled MFIs to raise more capital and grow much faster, and NBFC MFIs now account for more than four fifths of all MFI loans, dominated by the five largest MFIs, including SKS [6].

Relevance of the Study

The increased growth of micro finance is successful in attracting the needy poor borrowers across India. But at the same time the increased competition among the MFIs for market share, expansion of business and the motive for profit has resulted in increased use of unethical practices for recovery and repayment of loan. The micro finance institutions must be made aware of the role for which they were allowed to carry out the business activities and the importance to develop a feeling of serving the poor and to be satisfied by that alone than the profits. The study thus makes an attempt to identify the problems or the unethical practices of MFI in these days which are deviated by the objectives for which they were set up and throws light upon the urgent need for improved regulations or regulatory bodies to control the MFIs in India [7].

Objectives of the Study

The study is conducted with a view to ascertain the practices of selected MFIs in Karnataka in terms of providing the services and post service behaviour of the institutions which is damaging the Indian Micro Finance Status globally. The study is also required to find out how effective is RBI regulations on MFIs in India and what needs to be done at the earliest.

The objectives of the study can be listed as below.

1. To study the existing practices of MFIs as regards to Recovery of loans
2. To identify the effect of existing regulatory norms of RBI on MFIs.

Hypotheses of the Study

The following null and alternative hypotheses were formulated based on the objectives.

Ho - the existing practice of MFIs for recovery of loan are not significantly satisfactory to the borrowers

H_1 - the existing practice of MFIs for recovery of loan are significantly satisfactory to the borrowers

The study has made an attempt to find the answers to the objectives set with the help of above hypotheses and testing of the same.

Methodology of the Study

The study was conducted by taking respondents of 4 MFIs working in Dakshina Kannada and Shimoga Districts of Karnataka. The respondents are members of SHGs and general clients. As part of sampling, simple random sampling technique was used and 100 respondents were chosen from the population spread over these two districts taken for study. The responses for the services offered and the practices of MFIs with regard to recovery of loan, training and insurance services provided to the masses are taken into consideration through structured questionnaire. The data so collected has been tabulated and suitable conclusions are drawn through testing of Hypotheses.

To assess the RBI guidelines followed by these Micro Finance Institutions and the impact of the same, basic tools like percentage and frequencies to get the results and t-test has beenused in order to prove the hypothesis. Statistical analysis has been done using SPSS. The tested results have been presented with the help of simple Table 1.

Data Analysis and Interpretation

The present research work is done to ascertain the delivery of service by the MFIs and the opinion of the beneficiaries with regards to the loan recovery methods of the institutions. One of the major issues that the borrowers are facing now a day is about the increased pressure from the lending institutions for the repayment of the loan taken. If the intense methods are used by the institutions, it will have demoralising effects on the borrowers and if allowed it will lead to increased unethical practices on the part of MFIs. The study has attempted to analyse with the help of responses given here to have a fair idea whether the recovery methods adopted by the MFIs are in accordance with the RBI guidelines or not. The study has been conducted by taking into account both primary and secondary data. The responses have been carefully classified and presented in s to find out the results.

In order to test the hypotheses, 100 respondents from Dakshina Kannada and Shimoga districts of Karnataka have been selected and the responses taken from them through a structured questionnaire. The data so collected has been analysed with the help of SPSS and the results has been presented in the following Table 1.

The above Table 1 and Figure 2 shows that, around 53 percent of the respondents disagree in the conciliation method used by the MFIs while recovering the loans. Only 16 percent of the respondents strongly agree with the use of conciliation method being helpful to them. Around 67 percent of the beneficiaries strongly disagree that they are informed with all the other options for repayment is infirmed to them by the MFIs. Among the respondents, 70 percent of the responses strongly opine that the MFIs to which they are members use coercive or aggressive methods for recovery of loans like repeated reminders, visiting the houses of place of work demanding the repayment and intensify collection process. Only around 4 percent disagree with the coercive methods used by the MFIs. In connection with the legal recourse methods of the MFIs, 73 percent of the respondents strongly agree that without giving due time to repayment due legal recourse is being used as a means to recover the loans. The percentage who disagree with this more or less around 7 percent. It is evident from the above Table 1 that among the four methods which are normally used by the MFIs to make the borrowers to repay the loan, the coercive or aggressive method used by the MFIs is highly preferred by the borrowers as the method which is hurting them most. So, this clearly indicates that the MFIs are definitely involved in that practice which is strictly against to the norms laid down by the RBI which includes setting up of designated place for loan recovery and fair practice code provided in the circular issued to the NBFCs.

T-Test for testing the hypotheses

$$t_{cal}\left(Computed\ value\right) = \frac{2.5375 - 1.982}{1.2072} = 0.45$$

Table 2 presents the two tail test@5% level of significance, critical value is 1.982. As computed value (0.45) is less than the critical value

Methods for loan recovery	Responses	Frequency	Percent	Valid percent
Conciliation	Strongly agree	16	16.0	16.0
	Agree	28	28.0	28.0
	Neutral	3	3.0	3.0
	disagree	29	29.0	29.0
	Strongly disagree	24	24.0	24.0
	Total	100	100.0	100.0
All options for repayment	Strongly agree	13	13.0	13.0
	Agree	17	17.0	17.0
	Neutral	3	3.0	3.0
	Disagree	32	32.0	32.0
	Strongly disagree	35	35.0	35.0
	Total	100	100.0	100.0
Coercive/Aggressive/Intense methods	Strongly agree	70	70.0	70.0
	Agree	26	26.0	26.0
	Disagree	3	3.0	3.0
	Strongly disagree	1	1.0	1.0
	Total	100	100.0	100.0
Legal recourse	Strongly agree	31	31.0	31.0
	Agree	42	42.0	42.0
	Neutral	11	11.0	11.0
	Disagree	9	9.0	9.0
	Strongly disagree	7	7.0	7.0
	Total	100	100.0	100.0
Source: Primary data.				

Table 1: The methods for recovery of loan.

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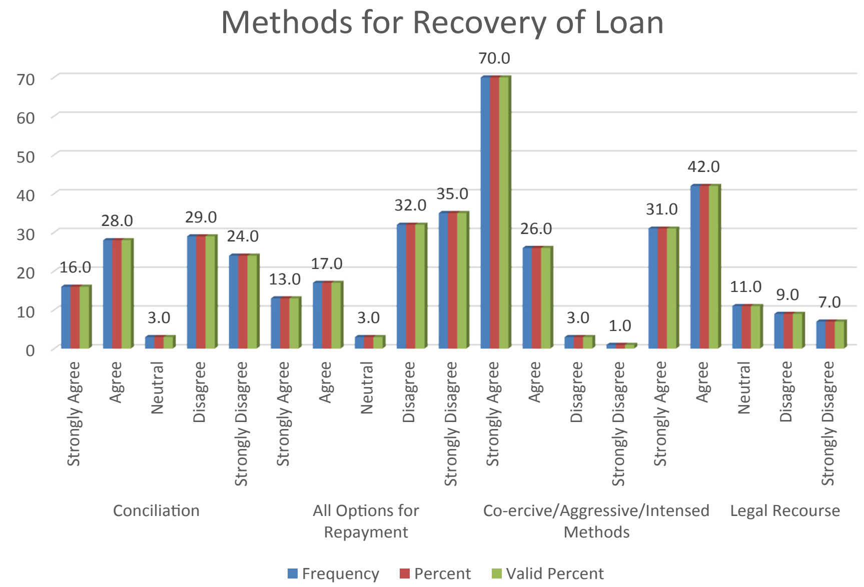

Figure 2: Methods for recovery of loan.

Methods for recovery of loan	N	Mean	Std. deviation	Test statistics
Conciliation	100	3.17	1.471	1.982
All options for repayment	100	3.59	1.443	
Coercive/Aggressive/Intense methods	100	1.39	0.737	
Legal recourse	100	2.	1.178	
Aggregate mean and standard deviation		2.5375	1.2072	
Source: Compiled from primary data.				

Table 2: Descriptive statistics on methods for recovery of loan.

(1.982), the null hypothesis (H_0) is accepted and alternative hypothesis (H_1) is rejected. Therefore, it can be concluded that, the existing practice of MFIs for recovery of loan is not satisfactory for the borrowers and it is not encouraging them to repay the loans in time.

As regards the second objective, based on the secondary data and primary data it can be observed that, MFIs are not strictly adhering to the regulatory norms provided by the RBI to NBFC-MFIs which includes capital adequacy, fair practice in lending, corporate governance, recovery of loan, compliance etc.

Findings and Suggestions

The present study on the services provided by the MFIs and the methods used to recover the loan reveals an important finding which should be essentially addressed in the days to come. It is identified from the analysis that majority of the borrowers are unhappy with the ways or means used by the MFIs as the methods are not encouraging them to repay the loans owing to their conditions instead it is proving stressful and morally discouraging the people. This is making the borrowers to turn away from the MFIs services and look for alternatives. If the trends are to be believed, the change in preferences of the MFIs borrowers is going to hurt the industry and a slump in the demand for the services cannot be ruled out anytime soon. As Majority of the MFIs in Karnataka are not abiding by the norms issued by the RBI and are moving towards profit making by charging higher interest, using coercive methods for recovery of loans and by not being transparent in their actions, it is the earnest opinion and suggestion from the researcher that the government and RBI should immediately interfere and initiate some actions to control the wrong doings of the MFIs and establish improved regulatory norms. The only solution to see the industry progressing for the good of the needy people is possible through the incorporation of effective governance [8-11].

Conclusion

The micro finance institutions are successful over the years to attract the large number of borrowers towards their financial products. The increase in the number of institutions and volume pf services is rightly attributed to the increased need and the convenience offered by the MFIs in delivery of the MFI services. But due to the unethical and unwanted practices of exceptional MFIs and some of the service providers of the industry, the outlook of the MFI services and the MFIs in India is deteriorating. The significant efforts of MFIs in transforming the lives of rural poor over the years should be upheld by channelizing the MFIs in right direction. This is possible only when proper system of regulations are governance practices have been implemented at the highest level. It is the time to think, discuss and demonstrate the efforts in this regard with a view of strengthening the micro finance in India.

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