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Short Communication

Micro Finance and Risk Management for Poor in India

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Abstract

Since independence, various governments in India have experimented with a large number of grant and subsidy based poverty alleviation programmes. These programmes were based on grant/subsidy and the credit linkage was through commercial banks only. As a result, these programmes became unsustainable, perpetuated a dependant status on the beneficiaries and depended ultimately on the govt. employees for delivery. This not only led to misuse of both credit and subsidy but banks never looked at it as a profitable and commercial activity as well. This paper stresses on improving farm level efficiency through micro financing and micro insurance in achieving their economic and social goals, which at present find have largely identified only limited success.

Keywords: Micro insurance, social goals, low income household.

Introduction

Microfinance is "small-scale financial services—primarily credit and savings—provided to people who farm, fish or herd" and adds that it refers to all types of financial services provided to low-income households and enterprises[1.] In India, microfinance is generally understood but not clearly defined. For instance, if an SHG gives a loan for an economic activity, it is seen as micro finance. But if a commercial bank gives a similar loan, it is likely that it would not be treated as microfinance. In the Indian context there are some value attributes of microfinance:

Microfinance is an activity undertaken by the alternate sector (NGOs). Therefore, a loan given by a market intermediary to a small borrower is not seen as microfinance.

However when an NGO gives a similar loan it is treated as microfinance. It is assumed that microfinance is given with a laudable intention and has institutional and non exploitative connotations. Therefore, we define microfinance not by form but by the intent of the lender.

Second, microfinance is something done predominantly with the poor. Banks usually do not qualify to be MFOs because they do not predominantly cater to the poor.

However, there is ambivalence about the regional rural banks (RRBs) and the new local area banks (LABs).

Third, micro finance grows out of developmental roots. This can be termed the "alternative commercial sector". MFOs classified under this head are promoted by the alternative sector and target the poor. However these MFOs need not necessarily be developmental in incorporation. There are MFOs that are offshoots of NGOs and are run commercially. There are commercial MFOs promoted by people who have developmental credentials. We do not find commercial organizations having microfinance business.

Last, the Reserve Bank of India (RBI) has defined microfinance by specifying criteria for exempting MFOs from its registration guidelines. This definition is limited to not-for-profit companies and only two MFOs in India qualify to be classified as microfinance companies.

Success stories in neighboring countries, like Grameen Bank in Bangladesh, Bank Rakiat in Indonesia, Commercial and Industrial Bank in Philippines etc, gave further boost to the concept in India in the 1980s. India thus adopted the similar model of extending credit to the poorest sector and took a number of steps to promote micro financing in the country. Critics of Indian regional rural banks (RRBs) and their prevailing culture have argued that a product-focused rather than a market-oriented approach to new service development (NSD) is responsible for their inadequate performance.

Low efficiency is a problem in most developing agriculture, and is one of the reasons for food insecurity[2]. A comparison of various farming practices shows that use of modern inputs and livestock-based capital could significantly improve farmers' performance. Estimations show that the major factors influencing performance are the level of education, gender and market access and off-farm capital. Thus, policies aimed at improving education, rural infrastructure as well as assuring farmers of income through improved livelihood opportunities, and therefore reduced perceived uncertainty, could improve farm-level efficiency.

This paper stresses on improving farm level efficiency through micro financing and insurance in achieving their economic and social goals such as food security in India, which at present find have largely identified only limited success.

Methodology

Types of Organizations and Composition of the Sector: Microfinance providers in India can be classified under three broad categories: formal, semiformal and informal.

Formal Sector: The formal sector comprises of the banks such as NABARD, SIDBI and other regional rural banks (RRBs). They primarily provide credit for assistance in agriculture and micro-enterprise development and primarily target the poor. Their deposits at around Rs. 350billion and of that, around Rs. 250billion has been given as advances. They charge an interest of 12-13.5% but if we include the transaction costs (number of visits to banks, compulsory savings and costs incurred for payments to animators/staff/local leaders etc) they come out to be as high as 21-24%.

Semi-formal Sector: The majority of institutional microfinance providers in India are semi-formal organizations broadly referred to as MFIs. Registered under a variety of legal acts, these organizations greatly differ in philosophy, size and capacity. There are over 500 non-government organizations (NGOs) registered as societies, public trusts, or non-profit companies.

Informal Sector: In addition to friends and family, moneylenders, landlords, and traders constitute the informal sector. While estimates of their importance vary significantly, it is undeniable that they continue to play a significant role in the financial lives of the poor.

Steps taken by India to promote micro financing: It set up development banks, such as SIDBI, NABARD which focused on rural credit and micro-financing. NGOs and SHGs were encouraged to become the government arm in extending micro-credit to the poor. They were provided supplementary credit needed to fund the credit, paper work was reduced between them and the banks. Also, the government assisted in mobilizing funds from formal financial institutions to meet the larger credit needs of these organizations.

Focus on Women for micro credits: A lot of Micro-financing schemes are now increasingly focusing on women primarily as well. There are compelling reasons for this.
Among the poor, the poor women are the most disadvantaged - they are characterized by lack of education and access to resources, both of which are required to help them work their way out of poverty and for upward economic and social mobility. The problem is more acute for women in countries like India, despite the fact that women labor makes a critical contribution to the economy. Evidence shows that groups of women are better customers than men - they are better managers of resources - benefits of loans are spread wider among the household if loans are routed through women - mixed groups are often inappropriate in Indian society - record of all-male groups is worse than that of all-women groups, everywhere.

Results and Discussion

In contrast to bank debt contracts, most micro-finance contracts require that repayments start nearly immediately after loan disbursement and occur weekly thereafter[3]. Even though economic theory suggests that a more flexible repayment schedule would benefit clients and potentially improve their repayment capacity, micro-finance practitioners argue that the fiscal discipline imposed by frequent repayment is critical to preventing loan default. Our findings suggest that, among micro finance clients who are willing to borrow at either weekly or monthly repayment schedules, a more flexible schedule can significantly lower transaction costs without increasing client default.

Paradigm shift regarding risk management is summarized in Table-1. Financial institutions should manage the risk effectively to survive in this highly uncertain world.

The agricultural sector which the state government shows drastic improvements is not corroborated with the visible outcome when the yield of food grains and other major crops (Kg/hectare) in the state (Orissa) showing a decline and volatile during post –reform period as opposed to the all India average[4]. Orissa is one of the poorest state in India in terms of low per capita income, low aggregate and sectoral growth, very high incidence of poverty, low occupational diversity and poor human development. The rural indebtedness in Orissa by regions is shown in table- 2.

Table-1
Paradigm Shift Regarding Risk Management

	Old World	New World
Philosophical attitude to risk	Risk is bad	Risk is our core business
Evaluation of business opportunities	Minimize risk	Prize for risk
Definition of risk appetite	Qualitative and obscure	Quantitative and qualitative
Scope of risk control	Excessive	Cost benefit Analysis
Goal of risk management	Stop risk taking	Optimize risk taking

Table- 2
Rural Indebtedness in Orissa by Regions

All Farmer Household	Unit	Orissa	All India
Farming HHs	In Lakhs	42.3	893.5
Outstanding amount of Farmer HHs	In Crores	2485.7	112445.4
Proportion of Farmer HHs Indebted	%	47.8	48.6
Average outstanding per farming HHs	Rs	5871	12585
Proportion of outstanding credit for production purposes	%	64.7	65.1

Source: NSS data on Situation Assessment of Farmers(NSSO,2005)

The challenge is how to how to arrest the decline in productivity of food grains and other major crops and assure desirable level of return to cultivation.

Minimizing risk in agriculture and ensure average return to cultivation. Since agriculture is the most risk prone activity, the risk of poor farmers related to input supply, production and market should be minimized. Micro insurance in the following area is needed:

Definite Loss: The event that gives rise to the loss that is subject to insurance should, at least in principle, take place at a known time, in a known place, and from a known cause. The classic example is death of an insured on a life insurance policy. Fire, automobile accidents, and worker injuries may all easily meet this criterion. Other types of losses may only be definite in theory. Occupational disease, for instance, may involve prolonged exposure to injurious conditions where no specific time, place or cause is identifiable. Ideally, the time, place and cause of a loss should be clear enough that a reasonable person, with sufficient information, could objectively verify all three elements.

Accidental Loss: The event that constitutes the trigger of a claim should be fortuitous, or at least outside the control of the beneficiary of the insurance. The loss should be 'pure,' in the sense that it results from an event for which there is only the opportunity for cost. Events that contain speculative elements, such as ordinary business risks, are generally not considered insurable.

Crop insurance: Farmers use crop insurance to reduce or manage various risks associated with growing crops. Such risks include crop loss or damage caused by weather, hail, drought, frost damage, insects, or disease, for instance.

Health insurance: Health insurance policies will often cover the cost of private medical treatments if the National Health publicly-funded health programs do not pay for them. It will often result in quicker health care where better facilities are available.

Micro credit for fertilizer, seeds and other modern farm input.Strengthing local micro financial institutions and employing rural youth for better input system could work better. Encourage private investments, reduction of transaction cost, expansion of agro processing and agricultural marketing.

Use of information technology/mobile phones for fast processing of micro finance and micro insurance. A mobile is available as cheap as Rs 600/-instrument with a call rate 1.0 paise/second.

Public investment in irrigation with focus on upland and remote areas, operation and maintenance of irrigation systems should be ensured to poor farmers.

Conclusion

Microfinance promises to trim down poverty. To achieve this noble objective microfinance institutions (MFIs) have to become steady profitable. The role of state government is crucial in augmenting farm investment, micro financing, micro insurance, facilitating private investment and spreading institutions. This would help the poor in realizing inclusive growth of the India. It will help in improving the farm level productivity and generate employment for youth.

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