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Micro Finance – a critical analysis

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Traditionally, banks have not provided financial services, such as loans to clients with little or no cash income. Banks incur substantial costs to manage a client account, regardless of how much small the sums of money involved. For example, the total gross revenue from delivering one hundred loans worth Rs.1,000 each will not differ greatly from the revenue that results from delivering one loan of Rs. 1,00,000, it takes nearly a hundred times as much work and cost to manage a hundred loans as it does to manage one. The fixed cost of processing loans of any size is considered as the assessment of potential borrowers, their repayment prospects and security administration of outstanding loans, collecting from delinquent borrowers, etc., has to be done in all cases. There is a break-even point in providing loans or deposits below which banks lose money on each transaction they make. Poor people usually fall below that breakeven point. A similar equation resists efforts to deliver other financial services to poor people.

In addition, most poor people have few assets that can be secured by a bank as collateral. This means that the bank will have little recourse against defaulting borrowers.

The efforts of national planners and experts to develop financial services for most people have often failed in developing countries like India. Therefore, when poor people want to borrow money they often rely on relatives or a local moneylender, whose interest rates are very high. An analysis of 28 studies of informal money lending rates in 14 countries in Asia, Latin America and Africa concluded that 76% of money lender rates exceed 10% per month, including 22% that exceeded 100% per month.

Moneylenders usually charge higher rates to poorer borrowers than to less poor ones. Over the past centuries practical visionaries from the Franciscan monks who founded the community-oriented pawnshops of the 15th century, to the founders of the European credit union movement in the 19th century (such as Friedrich Wilhelm Raiffeisen) and the founders of the microcredit movement in the 1970s (such as Muhammad Yunus) have tested practices and built institutions designed to bring the kinds

of opportunities and risk-management tools that financial services can provide to the doorsteps of poor people. While the success of the Grameen Bank (which now serves over 7 million poor Bangladeshi women) has inspired the world, it has proved difficult to replicate this success. In nations with lower population densities, meeting the operating costs of a retail branch by serving nearby customers has proven considerably more challenging. Hans Dieter Seibel, the board member of the European Micro finance Platform, is in favour of the group model.

Although much progress has been made, the problem has not been solved yet, and the overwhelming majority of people who earn less than \$1 a day, especially in the rural areas, continue to have no practical access to formal sector finance. Micro finance industry has been growing rapidly, and concerns have arisen that the rate of capital flowing into micro finance is a potential risk unless managed well.

Boundaries and principles

Poor people borrow from informal moneylenders and save with informal collectors. They receive loans and grants from charities. They buy insurance from state-owned companies. They receive funds transfers through formal or informal remittance networks. It is not easy to distinguish micro finance from similar activities. Ensuring financial services to poor people is best done by expanding the number of financial institutions available to them, as well as by strengthening the capacity of those institutions. In recent years there has also been increasing emphasis on expanding the diversity of institutions since different institutions serve different needs.