Microcredit and Microcredit Institutions – A Study

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Microcredit is the extension of very small loans to the unemployed, to poor entrepreneurs and to others living in poverty who are not considered bankable. These individuals lack collateral, steady employment and a verifiable credit history and therefore cannot meet even the most minimal qualifications to gain access to traditional credit. Borrowers take loans in order to develop a variety of income-generating farming and home-based manufacturing activities. This is the most important tool for addressing poverty as it may generate millions of tine businesses and these businesses will grow and pull their owners over the poverty line. Microcredit can be instrumental in economic development as well as social development. By adhering to proper microcredit initiatives, countries can foster their development and give their poorest citizens more power over their lives.

Difference between the Microcredit and Microfinance

Microcredit is a subcategory of microfinance that refers to the collective services undertaken to help people of weak economic backgrounds. Microfinance can include a range of activities like government subsidies, tax breaks, bigger loans, etc. these are often the initiatives of the government to uplift their poorer citizens. This umbrella term refers to a large diversity of financial services aimed at small entrepreneurs and poor individuals. Thus, microcredit is a part of microfinance, which is the provision of a wider range of financial services including savings and insurance, in addition to credit. Microfinance has proved to be one of the most innovative, sustainable, and effective tools for poverty alleviation.

Emergence of Microcredit

Microcredit is a financial innovation which originated in Bangladesh where it has successfully enabled extremely impoverished people to engage in self-employment projects that allow them to generate an income and, in many cases, begin to build wealth and exit poverty. In India, SKS Microfinance was founded in 1998 by Vikram Akula to provide loans to women living in poor regions of India. The SIDBI is another agency in India that supports the microfinance schemes followed by commercial banks also through partnering with regional microfinance institutions.

Advantage of Microcredit

1. Microcredit is founded on the idea that even little sums of loans may help people break free from poverty. People can have access to tiny loans which banks simply will not lend.

2. Microcredit provides for modest changes rather than large ones. When people's fundamental requirements are addressed, it's normal for them to preserve the money they don't need for a future emergency. This opens the door to additional investments and, eventually, greater income for individuals

3. Microcredit assists in developing entrepreneurship by giving the loans who are otherwise not bankable and can't dream of doing something at their own for want of fund. These entrepreneur, in turn, creates new job possibilities for others. That translates to tens of thousands of employment produced by the business solely for the aim of lifting people out of poverty. Job development through microfinance benefits people at all levels, not just entrepreneurs.

Limitation and Disadvantage of Microcredit

1. One of the main limitations of microcredit is that the amount of money lent to the people can't be very high. As the standards for lending are very low, most banks won't offer a huge amount of money. So it may be a problem for people who need a more substantial investment for a start.

2. Another disadvantage is that people feel very pressured to pay off the loans because they have high rates. The interest rates on these loans tend to be very high because of their risk factor, and it falls upon the very people who can least afford them, the poor people.

Types of microcredit/ microfinance Institutions in India

1. Joint liability Group : This is generally a small, informal group of 4-10 people who seek loans on the basis of mutual assurance. The loans are typically used for agriculture or related operations. This group of debtors includes farmers, rural laborers, and renters. Each member of group is equally liable for the timely repayment of the loan. Because it is basic in nature, this entity does not require any financial administration. However, one of the structure's major flaws is personal preferences in credit lending, which has resulted in the system's partial failure.

2. Self-help Group : A Self-Help Collection is a group of people from similar socioeconomic circumstances who get together to help one other. These small company owners band together for a limited time to form a shared fund for their mutual business requirements. These organizations are classed as non-profits. The debt collection is handled by the organization. This type of cooperative financing does not necessitate the use of collateral. In addition, borrowing rates are often cheap. Several banks have formed partnerships with SHGs in order to increase financial inclusion in the country's rural areas. One of the most important is the NABARD SHG linkage program, which allows numerous self-help groups to borrow money from banks if they can show that their borrowers have made regular payments.

3. Grameen bank model : Nobel Laureate Prof. Muhammad Yunus developed the Grameen Model in Bangladesh in the 1970s. Regional Rural Banks (RRBs) have been established in India as a result. The main purpose of this strategy is to boost the rural economy from start to finish. In India, however, SHGs have done better as MFIs than Grameen Banks. However, in India, this approach has not been completely implemented since rural credit and recovery systems are a major issue.

These regional banks also failed due to a large volume of non-performing assets. Self Help Groups have fared better than this approach since they are more suited to India's population density and significantly more sustainable.

4. Rural cooperatives : At the time of India's independence, rural cooperatives were founded. Poor people's resources were pooled, and financial services were offered through this fund. This approach, however, had complicated monitoring systems and was only useful to creditworthy borrowers in rural India. As a result, this strategy did not meet with the expected success. Furthermore, this system exclusively served credit-worthy persons in rural regions, excluding a substantial portion of the country's financially disadvantaged population.

Challenges of microcredit/microfinance Institutions

1. The failure of Micro credit lies in the fact that Micro Credit Institutions push loans in their anxiety to expand very fast without being careful in vetting. The result is that lenders often hand over money without taking the time to educate the borrowers, making sure they understand that they're supposed to start businesses and that there are penalties for not paying the money back. But, the loans don't always lead to businesses; in some cases they are even used to pay off previous debts and to pay for urgent expenses i.e. children’s school fee. The people receiving these loans do not know what this microcredit system is all about. Therefore, later, the borrowers use to borrow from other sources to repay the loans. That often means resorting to moneylenders or loans from friends and family to pay back the microloan and vice versa, trapping them in a cycle of debt. This results into non-repayment of loans on time making the micro-lenders unsustainable.
2. The Micro Credit Organizations have generally restricted themselves to a particular geographical area. This is the biggest reasons of small penetration in micro lending as the organizations fail in their attempts to reach those who needs micro credit. The outreach can be increased by creating a steady stream of Micro Credit Organizations in hitherto under-served and diverse geographies.
3. As the concept of microcredit evolves, some pioneering microcredit/microfinance institutions globally have begun pushing their mandate to loosely resemble that of financial institutions. These institutions, established primarily to lend small sums to the poor, are trying to make consumers out of them. For companies, such diversification means new distribution channels. Bangladesh’s now fabled Grameen Bank, founded by Nobel laureate Muhammad Yunus who pioneered the microcredit concept, has led the way to diversification, which is now catching up in India. In 1995, the group established Grameen Telecom (GTC) as a not-for-profit to sell cellphones to the poor, especially in rural areas. The big point in the MFI business is that if they start lending to (fund the purchase of) non-income-generating products, it adds to the risk of their business. such diversification bringing in more business for MFIs, but caution it could lead to over-indebtedness for the poor and more repayment defaults.
4. These institutions operate in developing and developed areas with minimal activity. As a result, they find it difficult to gain access to information for appraisal purpose. Their management

teams can't understand the quantity of quality information they have to develop investment decisions due to lack of consistent and trustworthy valuations methodology.

5. Very few of these institutions are self-sufficient and are incapacitated to withstand in long-term. The vast majority rely on contributions and subsidies to stay afloat, putting their long-term survival in jeopardy. Despite their economic models and "best practices" understanding, virtually all programs are heavily supported.
6. These institutions have a limited transaction volume and comparatively small presence in the market causing the higher cost of their operation and administration. The collection cost is also substantial due to higher frequency of loan recovery cycle coupled with smaller amount of recovery. These factors pose a considerable problem for all of them.
7. These institutions provide loans without collateral security and that to financial weaker section resulting in high risk of default and bad debts. Borrowers failure to manage their debts leads to loan default, which stymies the expansion of these institutions.

To conclude, as an important element of poverty reduction initiatives, microcredit can help to improve the poor's creditworthiness and make them more "bankable."

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