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INTEREST FREE MICROFINANCE: A GATEWAY OF FINANCIAL INCLUSION FOR KERALA

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ABSTRACT

Microfinance is a powerful poverty alleviation tool. It implies provision of financial services to poor and low-income people whose low economic standing excludes them from formal financial systems. Access to services such as, credit, venture capital, savings, insurance, remittance is provided on a micro-scale enabling participation of those with severely limited financial means. The provision of financial services to the poor helps to increase household income and economic security, build assets and reduce vulnerability; creates demand for other goods and services; and stimulates local economies. A large number of studies on poverty however, indicate that exclusion of the poor from the financial system is a major factor contributing to their inability to participate in the development process. In a typical developing economy the formal financial system serves no more than twenty to thirty percent of the population. The vast majority of those who are excluded are poor.

Keywords:
Financial Inclusion, Microfinance, Poverty, Loans & Deposits.

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1. INTRODUCTION

WHAT IS MICROFINANCE?

Microfinance is 'the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to poor and low income households and, their micro enterprises'. Microfinance was emerged mainly for the poor people and those who are economically disabled to go with banking transactions. Intrinsically, there is no any specified method of microfinance. Any institution or enterprise which is easily accessible for the poor to pursue their financial transactions could be referred as microfinance institution. It is the main gateway of financial inclusion. Its growth can boost financial inclusion.

THE RELEVANCE OF MICROFINANCE

Financial inclusion is the real remedy of poverty alleviation and economic development. Financial inclusion is defined as the access, availability and usage of the formal financial system by all members of economy. As is customary, the low graded people couldn't access to enjoy the facilities of banking and other financial services which are completed with the affluent people. Private money lenders charge very high interest rates. This makes it difficult for poor people to access funds for starting small income-providing businesses.

Microfinance is a very effective development tool. That is why, the Secretary General of the United Nations declared the year 2005 as "International Year of Microcredit". Microfinance is also a very flexible tool, that can be adapted in every environment, based on the local needs and economic and financial situation. For example, in Asia, community micro-lending proved to be very effective, while in Egypt or in Brazil beneficiaries prefer individual lending. Microfinance can be effective both in the South of the world and in Western countries, equally characterized by financial and social exclusion.

RECOMMENDATION OF RAGURAM RAJAN COMMITTEE

The Raguram Rajan committee submitted before the government a perfect report which announces the immediate potentiality of interest free micro finance. As his report reveal, "India's poor, many of who work as agricultural and unskilled wage labourers, micro entrepreneurs and low salaried workers are largely excluded from the formal financial system. Over 40% of India's working population earn but have no savings. Even accounting for those with financial savings, too large a proportion of the poor lie outside the formal banking system. For example, only 34.3% of the lowest income quartile has savings, and only 7.7 % have a bank account. By contrast, in the highest income quartile, 92.4%have savings and 86.0% have bank accounts. Similarly, 29.8% of the lowest income quartile had taken a loan in the last two years, but only 2.9 percent had loans from banks (about one tenth of all loans), while 16.3% of the highest income quartile had loans and 7.5% had loans from banks (about half of all loans)'.

Being implemented in various nook and cranny of the country, microfinance can reduce the financial exclusion and poverty alleviation. As the report continues, 'microfinance is the fastest growing non institutional channel for financial inclusion in India. A key factor that influenced the success of microfinance was its ability to fill the void left by mainstream banks that found the poor largely credit less worthy, and were unable to design products that could meet the needs of this segment in a commercially viable manner. Using group based lending and local employees, microfinance provides financial services using processes that work, and in close proximity to the client. These qualities facilitated the proliferation of microfinance from a virtually non-existent activity in 1990 to a small, but increasingly important, source of finance for India's poor'.

Likewise, to enquire the problems of financial inclusion in India, the Government of India made a "Committee on Financial Inclusion" under C. Rangarajan as its chairman. Submitting the full report to then-incumbent Union Finance Minister on 4 January 2008, many suggestions were held to operate lots of microfinance institutions in the divergent parts of the country.

PROBLEMS WITH INTEREST BASED MICROFINANCE

The conventional financial system has hit the microfinance with its exploiting methods. The conventional banks and other private enterprises which is not Shariah complied force a high rate of interest with the pertained transactions. Unfortunately, the interest rate is charged more than 40% in many places.

Due to being interest based, the rate of farmer suicide is in considerable increase. According to India's National Crime Records Bureau, more than 87,000 farmers committed suicide between 2002 and 2006 because of failing harvests and huge debts. Sudhirendhar Sharma, an ex-analyst of World Bank and the incumbent director of Delhi based Ecological Foundation observed that the interest based microfinance is a main reason for this problem. Also, Reserve Bank of India appointed a committee under Y. H. Malegam to study about the condition of microfinance in the country. He also suggested for a considerable reduction in the interest rate.

RELEVANCE AND POTENTIALITY OF INTEREST FREE MICROFINANCE

India's GDP ranks among the top 15 economies of the world. However, around 300 million people or about 60 million households, are living below the poverty line. It is further estimated that of these households, only about 20 percent have access to credit from the formal sector.

Additionally, the segment of the rural population above the poverty line but not rich enough to be of interest to the formal financial institutions also does not have good access to the formal financial intermediary services, including savings services.

The annualized credit usage of all poor families (rural and urban) is estimated at over Rs. 45,000 crores, of which some 80 percent is met by informal sources.

Microfinance is emerging as an instrument to address poverty in the new economy. However, the present practices of micro- finance are based on interest-based lending, which varies from 30% to 150% per annum besides other maladies involved in Self Help Group (SHG) formation of specific sex group.

INTEREST FREE MICROFINANCE IN INDIA AND ITS SCOPE

As Arjun Singh Gupta proposed, 70% of Indian population gets an income of about Rs. 20 daily. Though there is no any access to embark on interest free banks in India, hundreds of Interest free microfinance institutions and enterprises are successfully working here, financing micro level and charging no interest. There are a lot of interest free funds known as Muslim Funds. They provide loans from Rs 500 to Rs 25000 to needy persons. Such exertions are praiseworthy and should put forward in all level of societies.

Though the possibility of implementation of Interest free Banks is very remote, they can use microfinance facility to revel in the interest less transaction. India has really many possible structures of interest free microfinance.

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INTEREST FREE MICROFINANCE IN KERALA

As far as Kerala state is concerned, it has become a paradigm for all states of the country. Because, in Kerala, many interest free enterprises and efforts have emerged through viable trick ways, within the parameters of Indian rules and regulations. Kerala Muslims have introduced many microfinance methods legally. According to a study of Rahmathullah, the highest number of microfinance institutions is situated in Kerala. And in this case, Kerala is followed by Uttar Pradesh, Andhra Pradesh, Maharashtra and Karnataka.

Stepping into the deep core of study about interest free enterprises in Kerala, we can conclude that there are hundreds of interest free institutions operating in various methods of micro level transactions. Kerala has become a role model for all places in the *Nidhi* system. Nidhi means interest free mutual funds as far as Kerala muslims are concerned. There are more than 1000 Nidhis in Kerala – registered and unregistered. All of them provide loans from Rs 500 to Rs 25000 to the needy persons with no collateral securities and often with gold or persons as securities. Such institutions help reduce debt burden and related pitfalls of poor people. So, this is a good system to reduce the rate of poverty.

Many interest free finance institutions also give interest free loans in micro level like AICL and many education enterprises. Likewise, students at educational institutions and workers in a specified labour also transact community business. This is by collecting a distinct amount from the members and investing and bagging it in adequate proportion and later by giving them back as per their needs. Malappuram, Palakkad and Calicut are the three districts which provide an imperative role in interest free microfinance in Kerala.

Also, there are a lot of microfinance facilities operating in different parts of Kerala being conducted through various methods. Henceforth, the important methods of microfinance have been explained below in detail.

POPULAR MODELS OF INTEREST FREE MICROFINANCE

Interest free microfinance is getting untenable ample support from all cones of the world. The main countries, which witness the microfinance revolution, are Bangladesh, Indonesia, India, Morocco and Sri Lanka. As for Kerala, many of them are still being applied. Also, many of them are originated in India and refurbished its platform in Kerala. Now there are a lot of methods of Interest free microfinance. Mostly, its operations are characterized by small, usually short-term loans, efficient, simplified borrower and investment appraisal; quick payment of repeat loans after timely repayment; and convenient location and timing of services. Ten major popularized models of Interest free microfinance are as follows:

1. Self Help Group (SHG) model

Each Self Help Group is formed with about five to twenty members who are relatively similar in terms of income. An SHG essentially collects together its members' savings and uses it for lending. SHGs also seek external funding to supplement internal resources. The terms and conditions of loans are different in all SHGs, as per their physical conditions. Typical SHGs are promoted and supported by NGOs, but the main aim is to become self-sufficient institutions.

Some NGOs act as financial mediators for SHGs, while others act solely as ‘social’ intermediaries seeking to facilitate linkages of SHGs with either licensed financial institutions or other funding agencies. The SHG model is a good platform for combining microfinance with other developmental activities.

In Kerala, in this model, the members gather and register the group with an adequate institution mainly in Panchayats. Therefore, they provide loans and help with no interest.

2. Nidhi Model

The Nidhi (Fund) model is the most using method in microfinance. As for Iran, there are above 6000 Funds or Nidhis. In India, there are about 1000 Funds. In northern India, it is known as Muslim Funds or Bila Sudi Funds It is plenty in many nations. This is a direct credit lending model. It can be run requiring no registration or permission from any government authorities. So, almost all the Nidhis are in unorganized sector. By dint of this system, a common fund is collected through savings or donations and it is given as micro loans to the poor or needy people. Such type of institutions is working in India since 19^{th} century. Some Nidhis have been registered under Societies Act or as charitable trusts.

3. Non Governmental Organization (NGO) Model

Non Governmental Organization (NGO) is significant players in the field of microfinance. They behave as intermediaries in different cases. They are on the boil in conducting various awareness programs about the importance of microcredit within the society. They also propound many opportunities to be intimated with the principles and practice of microfinance like publications, seminars, and training programs. Very few NGOs provide loans directly to the needy people. Most of them act as promoters of SHGs. Globally, there are many functioning NGOs in different parts of the world. Mainly the contract is between the members.

4. Cooperative Societies Model

A cooperative is an independent association of people who come together voluntarily to meet their mutual economic, social and cultural aspirations and needs through a jointly owned and democratically controlled enterprise. The loan can get only after the reorganization of the director board. Cooperative was first registered in India in 1908.

But, as for the case of Kerala, this model would be mixed with interest. In India, the option of interest free finance is available only through two legal routes. One is NBFC and another is Cooperative credit societies under liberal acts enacted after 1995in Ten Indian states and a central act for multi-state cooperative societies. In Kerala, it is very risk to pursue with cooperative societies to have Interest free microfinance. Therefore, multi-state cooperative societies came. It is a well-furnished system including two or more states.

5. Commercial Banks

There are a lot of commercial banks in various corners of the world. Many commercial banks have microfinance unit. These institutions specially provide funds for development of microenterprises, social development, self-employment projects and agricultural promotion. The renowned bank in this method is HSBC Amanah. HSBC Amanah is the Interest free finance unit of HSBC, a multinational conventional bank. HSBC Amanah is available in Sri Lanka and

Pakistan. Another example is Citi Islamic of Citi Bank. But, this is not available in Kerala and even in India.

6. Rural Banking

Rural bank is also not available in India for Interest free microfinance. It is also known as village model. It is widely popularized in Latin America and Africa. The model involves an implementing agency that establishes individual village banks with about thirty to fifty members and provides "external" capital for onward financing to individual members. Individual loans are repaid at weekly intervals over four months, at which time the village bank returns the principal with profits to the implementing agency.

A bank repaying in full is eligible for subsequent loans, with loan sizes linked to the performance of village bank members in accumulating savings. Peer pressure operates to maintain full repayment, thus assuring further injections of capital, and also encourages savings. Savings accumulated in a village bank is also be used for financing. As a village bank accumulates sufficient capital internally, it graduates to become an autonomous and self-sustaining institution. This model has been very successfully implemented in a Shariahh-compliant manner in Jabal al-Hoss, Syria. A new experiment by FINCA in Afghanistan also seeks to implement this model. In Indonesia, there are about 105 rural banks; full of them introduced only microfinance facility. This model of microfinance is very rare in India.

7. Non-Banking Financial Company (NBFC) Model

The NBFC model is pursued in different countries mainly in India and Pakistan. The first step of this group after its formation is to register under the law prevailed in the country. In India, the Non-Banking Financial Companies are registered under RBI. The working capital is collected through shares and giving loans to micro entrepreneurs. Though the NBFC is more suited for investment rather than microfinance.

In Kerala, the Shariah complied NBFC is Alternative Investment and Credits Limited (AICL). As far as the Interest free NBFCs are concerned, Kerala is proud of being the first NBFC in India is situated in Kerala.

8. Association of Persons

Association of Persons is a better way for providing micro loans. It is also operated mainly in unorganized sector. A group of people who do not reach the tally of 50 gather to form an association through which many microfinance activities are brought forward. In some countries, a legal body can also form an association. The association collects saving from its members and then distribute it among the members as loans.

In Kerala, a number of Associations of Persons are working without any problem. Also, this type of service needs no registration.

9. Grameen Bank Model

The Grameen Bank model is famous model of microfinance. The model requires careful targeting of the poor through means tests comprising mostly of women group. The model requires intensive fieldwork by staff to motivate and supervise the borrower groups. Groups

normally consist of five members, who guarantee each other's loans. A number of variants of the model exist; but the key feature of the model is group-based and graduated financing that surrogate collateral as a tool to mitigate default and delinquency risk. An early Grameen replication that sought to offer Shariahh-compliant MF is Amana Ikhtiar Malaysia (AIM).
But, it is not applied in India. So, Indians are unaware of this system. It couldn't be counted in the applicable methods of Interest free microfinance for Kerala.

10. Credit Union (CU)

A Credit Union is based on the concept of mutuality. It is in the nature of non-profit financial cooperative owned and controlled by its members. CUs, mobilize savings, provide loans for productive and provides purposes and have memberships which are generally based on some common bond. CUs generally relate to an apex body that promotes primary credit unions and provides training while monitoring their financial performance. A Credit Union membership is free to all, and its members have the right to elect its main steward as the committee representatives. Credit Unions are quite popular in Asia, notably in Sri Lanka. It is also not popular in India.

INTEREST FREE NIDHIS: A BOOST FOR FINANCIAL INCLUSION OF KERALA

Interest free Nidhis or Funds are considered as a major type of microfinance venture. Due to the inconvenience of implementation of Interest free banking, as earlier mentioned, many muslims are excluded from the interest based financial sector. Therefore, many muslims thought about bringing any sort of Shariah complied service which could be more useful for the poor and excluded people. As a great fruition, the Nidhis or Funds came to the public arena in Kerala. They all were region-based. These Nidhis were started and managed by different muslim organizations, charitable trust, Mahallu committees and social workers.There were many discussions and heated thoughts about the operation of Nidhis. A key contributor to this is Ustad M M Basheer Musliar.

Generally, a group of interested persons from a locality may decide for reducing the exploitation of interest from their society. They amass a small amount of money from themselves or try to get donations and grants from outside. Subsequently, they form a formal body and try to provide the loans to needy persons with three months to one year intervals. Reliable sources explained that there are more than five hundred such Nidhis in Kerala.

Many of them are regulated by some private organizations. After collecting funds, they allow loans for needy people for small trades, house repairing cultivation, self-employment projects, medical treatment and durable consumption purposes. The self-employment projects include production of vegetables, note books, umbrellas, school bags, school uniforms and other commodities.

There are a lot of such groups. In many places, there are many groups known as *Ayalkoottam.* In this venture, a group of 10 to 30 persons join to form an organization. Afterwards, they amass the required fund from themselves and as donation. Then, they take 40% of the savings for transacting a lower business, another 40% for handloom productions and the 20% as kept money.

Thus, they transact in Shariah complied ways. For such venture, many places were named after their strivings such as Samoosappadi at Koottilangadi in Malappuram.

In fact, interest-free Microfinance Institutions have ample opportunities in the present situation of Kerala in favour of low income group to bring a positive socio-economic change. The basic challenge is to launch marketable and ethical & socially responsible products. It is also required to establish capacity building centers, monitoring and auditing agency to be in high level.

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