AN OVERVIEW OF MICROFINANCE IN INDIA

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ABSTRACT

In a country like India where 70 percent of its population lives in rural area and 60 percent depend on agriculture (according to the World Bank reports), microfinance can play a vital role in providing financial services to the poor and low income individuals. Microfinance is the form of a broad range of financial services such as deposits, loans, payment services, money transfers, insurance, savings, micro-credit etc. to the poor and low income individuals. The importance of microfinance in the developing economies like India can not be undermined, where a large size of population is living under poverty and large number of people does not have an access to formal banking facilities. The taskforce on Supportive Policy and Regulatory Framework for Microfinance constituted by NABARD defined microfinance as "the provision of thrift, saving, credit and financial services and products of very small amount to the poor’s in rural, semi urban and urban areas for enabling them to raise their income level and improve their standard of living." (Sen, 2008) Microfinance is regarded as a useful tool for socio-economic up-liftmen in a developing country like India. It is expected to play a significant role in poverty alleviation and development. There are two broad approaches that characterize the microfinance sector in India is Self Help Groups (SHGs)-Bank linkage programme and Microfinance Institution (MFIs). In India microfinance is dominated by Self Help Groups (SHGs)-Bank linkage programme aimed at providing a cost effective mechanism for providing financial services to the unreached poor. The present paper aims at identifying the current status and role of microfinance in the development of India.

Keywords: Microfinance; SHGs, MFIs; Status and Growth of Microfinance

INTRODUCTION

In early 1980’s, the existing banking policies, procedures and systems were not suited to meet the requirements of poor. For borrowings poor people usually resort to unorganised sector. NABARD recommended that alternative policies, systems and procedures should be put in use to save the poor from the clutches of moneylenders. Thus microfinance was introduced in banking sector. Microfinance is a programme which includes a broad range of financial services such as deposits, loans, payment services, money transfers, insurance, savings, micro-credit etc. to support the poor people and low income individuals. Mohammed Yunus was awarded the Noble Prize for application of the concept of microfinance, with setting up of the Grameen Bank in Bangladesh.
According to the records of World Bank, India falls under low income class. It is second populated country in the world. 70 percent of its population lives in rural area. 60% of people depend on agriculture; as a result, rate of underemployment is high. Rural people have very low access to institutionalized credit (from commercial bank). Since 1990s, poverty reduction has taken priority at both national and international development levels. Within this framework, various initiatives have been taken by government. Microfinance has caught the attention as an effective tool for poverty reduction and socio-economic development. Hence Microfinance can play a vital role for improving the standard of living of poor.

In India, the beginning of microfinance movement could be traced to Self Help Group (SHG) – Bank Linkage Programme (SBLP) started as a pilot project in 1992 by NABARD. This programme proved to be very successful and has also developed as the most popular model of microfinance in India.

The regulatory framework for microfinance in India is not unified. Microfinance is provided by commercial banks, Regional Rural Banks (RRBs), the SHG’s, cooperative societies and institutions (MFIs) that take various forms, including those of NGO’s and Non-Bank Financial Institutions (NBFI’s). Banks and NBFI’s are governed by the Reserve Bank of India (RBI), SHGs are regulated by NABARD, and the cooperatives are governed by Registrar of Cooperative Societies (RCS) etc.

OBJECTIVES OF THE STUDY

1. To understand the concept of microfinance, evolution and delivery models of microfinance in India.
2. To examine the role and importance of microfinance in India.
3. To examine the current status and growth of microfinance in India.

RESEARCH METHODOLOGY

This is a descriptive research paper based on secondary data. Data have been collected through books, various websites, magazines, newspapers, and publications of recent research papers available in different websites, Research Articles, Research Journals, E-Journals, RBI Report, and Report of NABARD etc.

Concept of Microfinance

The concept of microfinance was created by Professor Muhammad Yunus founder of Grameen bank in Bangladesh and noble price winner in 2006.

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to the poor and low income households and their micro-enterprises. Microfinance is defined as Financial Services (savings, insurance, fund, credit etc.) provided to poor and low income clients so as to help them raise their income, thereby improving their standard of living.

The Asian Development Bank (2000) defines microfinance as the provision of broad range of services such as savings, deposits, loans, payment services, money transfers and insurance to the poor and low income households and their micro-enterprises. This definition of microfinance is not restricted to the below poverty line people but it includes low income households also.

The taskforce on Supportive Policy and Regulatory Framework for Microfinance constituted by NABARD defined microfinance as “the provision of thrift, saving, credit and financial services and products of very small amount to the poor’s in rural, semi urban and urban areas for enabling them to raise their income level and improve their standard of living.” (Sen, 2008).

Features of Microfinance

1. It is an essential part of rural finance.
2. It deals in small loans.
3. It basically caters to the poor households.
4. It is one of the most effective and warranted Poverty Alleviation Strategies.
5. It supports women participation in electronic activity.
6. It provides an incentive to grab the self employment opportunities.
7. It is more service-oriented and less profit oriented.
8. It is meant to assist small entrepreneur and producers.
9. Poor borrowers are rarely defaulters in repayment of loans as they are simple and God-fearing.

Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Micro credit and micro-finance both are different. Micro credit is a small amount of money, given as a loan by a bank or any legally registered institution, whereas, Micro-finance includes multiple services such as loans, savings, insurance, transfer services, micro credit loans, etc. for poor people.

**Evolution of Microfinance in India**

The evolution of Indian Microfinance sector can be broadly divided into four distinct phases:

**Phase 1: The Cooperative Movement (1900-1960)**

During this phase, credit cooperatives were vehicles to extend subsidized credit to villages under government sponsorship.

**Phase 2: Subsidized Social Banking (1960s - 1990)**

With failure of cooperatives, the government focused on measures such as nationalization of Banks, expansion of rural branch networks, establishment of Regional Rural Banks (RRBs) and the setting up of apex institutions such as the National Bank for Agriculture and Rural Development (NABARD) and the Small Scale Industries Development Bank of India (SIDBI), including initiation of a government sponsored Integrated Rural Development Programme (IRDP). While these steps led to reaching a large population, the period was characterized by large-scale misuse of credit, creating a negative perception about the credibility of micro borrowers among bankers, thus further hindering access to banking services for the low-income people.


The failure of subsidized social banking triggered a paradigm shift in delivery of rural credit with NABARD initiating the Self Help Group (SHG) Bank Linkage Programme (SBLP), aiming to link informal women's groups to formal banks. The program helped increase banking system outreach to otherwise unreached people and initiate a change in the bank's outlook towards low-income families from 'beneficiaries' to 'customers'. This period was thus marked by the extension of credit at market rates.

The model generated a lot of interest among newly emerging Microfinance Institutions (MFIs), largely of non-profit origin, to collaborate with NABARD under this program. The macroeconomic crisis in the early 1990s that led to introduction of the Economic Reforms of 1991 resulted in greater autonomy to the financial sector. This also led to emergence of new generation private sector banks that would become important players in the microfinance sector a decade later.

**Phase 4: Commercialization of Microfinance: The First Decade of the New Millennium**

Post reforms, rural markets emerged as the new growth drivers for MFIs and banks, the latter taking interest in the sector not only as part of their corporate social responsibility but also as a new business line. On the demand side, NGO-MFIs increasingly began transforming themselves into more regulated
legal entities such as Non Banking Finance Companies (NBFCs) to attract commercial investment. The microfinance sector as it exists today essentially consists of two predominant delivery models the SBLP and MFIs. Four out of five microfinance clients in India are women.

**Microfinance Delivery Models In India**

The non-availability of credit and banking facilities to the poor and underprivileged segments of the society has always been a major concern in India. The Government and the Reserve Bank have taken several initiatives, from time to time, such as nationalisation of banks, prescription of priority sector lending norms and concessional interest rate for the weaker section of society. It was, however, realised that further direct efforts were required to address the credit needs of poor people. In response to this requirement, the Micro finance movement started in India with the introduction of SHG bank linkage programme (SBLP) in the early 1990s. At present, there are mainly two models for delivery of Microfinance in India:

1. SHG – Bank Linkage Programme (SBLP)
2. Micro Finance Institutions (MFIs)

The above models explained below:-

**SHG- Bank Linkage Programme (SBLP):** A SHG is a small group of about 10-20 persons from a homogeneous class of rural and urban poor which promoted savings among members and used these resources for meeting their credit needs. The group is democratically formed and elects its own leaders. The vital features of SHGs are it consists of members belonging to the same community or society and having common economic goal. In this model, the informal SHGs are credit linked with the formal financial institutions. The SHG-Bank Linkage Model has emerged as a dominant model in terms of number of borrowers and loans outstanding. This model is flexible, independence creating, and imparts freedom of saving and borrowing according to the requirements of group members. Due to widespread rural bank branch network, the SHG-BLM is very suitable to the Indian context. Microfinance movement started in India with the introduction of SHG-Bank Linkage Programme (SHG BLP). The programme uses SHGs as an intermediation between the banks and the rural poor to help in reducing transaction costs for both the banks and the rural clients. Banks provide the resources and bank officials/NGOs/ government agencies organise the poor in the form of SHGs. Under this programme, loans are provided to the SHGs with three different methodologies:

Model I: SHGs Formed and Financed by Banks: In this model, banks themselves take up the work of forming and nurturing the groups, opening their savings accounts and providing them bank loans.

Model II: SHGs Formed by Agencies Other than Banks, but Directly Financed by Banks: In this model, NGOs and other formal agencies in the field of microfinance facilitate organising, forming and nurturing of SHGs and train them in thrift and credit management. The banks directly give loans to these SHGs.

Model III: SHGs Financed by Banks Using Other Agencies as Financial Intermediaries: This is the model where the NGOs take on the additional role of financial intermediation along with the formation of group. In areas where the formal banking system faces constraints, the NGOs are encouraged to form groups and to approach a suitable bank for bulk loan assistance. This method is generally used by most of the NGOs having small financial base.

**Micro Finance Institutions (MFIs):** The MFI model has also gained momentum in India in the recent past. MFI model is found worldwide whereas the SHG-BLM model is an Indian model. In MFI model MFIs borrow large amount of funds from the apex financial institutions, donors and banks for on-lending to the individuals or groups. These MFIs provide financial services to the individuals or to the groups like SHGs. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual
guarantee. MFIs in India exist in a variety of forms like trusts registered under the Indian Trust Act, 1882/Public Trust Act, 1920; societies registered under the Societies Registration Act, 1860; Cooperatives registered under the Mutually Aided Cooperative Societies Acts of the States; and non-banking financial companies (NBFC)-MFIs, which are registered under Section 25 of the Companies Act, 1956 or NBFCs registered with the Reserve Bank. These MFIs are scattered across the country and due to the multiplicity of registering authorities.

**Role and Importance of Microfinance**

According to the research done by the World Bank, India is home to almost one third of the world’s poor (surviving on an equivalent of one dollar a day). Though many central government and state government poverty alleviation programs are currently active in India, microfinance plays a major contributor to financial inclusion. In the past few decades it has helped out remarkably in eradicating poverty. Reports show that people who have taken microfinance have been able to increase their income and hence the standard of living.

Thus Microfinance plays a major role in upliftment of Indian economy in following ways:-

- **Credit to Rural Poor**: Usually rural sector depends on non-institutional agencies for their financial requirements. Micro financing has been successful in taking institutionalized credit to the doorstep of poor and have made them economically and socially sound.

- **Poverty Alleviation**: Due to micro finance poor people get employment. It also helps them to improve their entrepreneurial skills and encourage them to exploit business opportunities. Employment increases income level which in turn reduces poverty.

- **Women Empowerment**: Normally more than 50% of SHGs are formed by women. Now they have greater access to financial and economical resources. It is a step towards greater security for women. Thus microfinance empowers poor women economically and socially.

- **Economic Growth**: Finance plays a key role in stimulating sustainable economic growth. Due to microfinance, production of goods and services increases which increases GDP and contributes to economic growth of the country.

- **Mobilisation of Savings**: Microfinance develops saving habits among people. Now poor people with meagre income can also save and are bankable. The financial resources generated through savings and micro credit obtained from banks are utilised to provide loans and advances to its members. Thus microfinance helps in mobilisation of savings.

- **Development of Skills**: Micro financing has been a boon to potential rural entrepreneurs. SHGs encourage its members to set up business units jointly or individually. They receive training from supporting institutions and learn leadership qualities. Thus micro finance is indirectly responsible for development of skills.

- **Mutual Help and Co-operation**: Microfinance promotes mutual help and co-operation among members. The collective effort of group promotes economic interest and helps in achieving socio-economic transition.

- **Social Welfare**: With employment generation the level of income of people increases. They may go for better education, health, family welfare etc. Thus micro finance leads to social welfare or betterment of society.

**Current Status and Growth of Microfinance in India**

Microfinance has a long history of helping the bottom of the economic pyramid to build assets and achieve a standard of living. Indian Government has considerably enhanced allocation for the provision of education, health, sanitation and other facilities which promote capacity building and well being of the poor. The Indian government puts emphasis on providing financial services to the poor and underprivileged since independence.
The microfinance sector has grown significantly today. The fact that national bodies like Small Industries Development Bank of India (SIDBI) and National Bank for Agriculture and Rural Development (NABARD) are devoting significant time, energy and financial resources on microfinance is an indication of the reckoning of the sector. The strength of the microfinance organizations (MFOs) in India is in the diversity of approaches and forms that have evolved over a period of time. While India has its home-grown model of SHGs, and mutually aided co-operative societies (MACS) there is significant learning from other microfinance experiments across the world, particularly Bangladesh, Indonesia and Thailand.

**Growth and Outreach**

According to Sa-Dhan’s (The Association of Community Development and Microfinance Institutions) “Bharat Microfinance Report – 2015” MFI’s currently operate in 28 States, 5 Union Territories and 568 districts in India. The reported 156 MFI’s with a branch network of 12,221 have reached out to an all-time high of 37 million clients with an outstanding loan portfolio of Rs 48,882 Crore. This includes a managed portfolio of Rs 9854 Crore. The average loan outstanding per borrower stood at Rs 13,162 and 80% of loans were used for income generation purposes.

Outreach grew by 13% and loan outstanding grew by 33% over the previous year. The Southern region continues to have the highest share of both outreach and loans outstanding, followed by East. However growth rates are higher in the North-eastern and Central regions. Outreach proportion of urban clientele is increasing year on year as against the rural population. The proportion of urban clientele which was 44% in 2013-14 increased to 67% in 2014-15. Women borrowers constitute 97% of the total clientele of MFI’s, SC/ST borrowers constitute 28% and minorities 18%.

Of the total, NBFC-MFI’s contribute to 85% of clients outreach and 88% of outstanding portfolio, while NGO MFI’s contribute to the remaining. MFI’s with portfolio size of more than Rs 500 Crore contribute significantly to the total outreach (82%) and loan outstanding (85%) of the sector.

**Top 10 MFI’s in India by Geographical Spread**

Ujjivan Financial Services has the largest geographical spread with operations across 24 states compared to 22 states for Bandhan Bank and 19 states for SKS Microfinance.

**Top 10 MFI’s with Loan Portfolio Outstanding**

Bandhan Bank is once again the leader followed by SKS Microfinance; Janalakshmi which is an urban focused MFI is placed third with Rs 3774 Crore outstanding.
According to the Bharat Microfinance Report – 2015, 2014-15 can described as watershed year as far as the rural-urban divide in Indian microfinance is concerned. A very interesting trend is seen in the rural-urban focus of MFIs. The share of rural clientele which was 69% in 2012 decreased to 56% in 2014 and has drastically come down to 33%.

The proportion of rural to urban clients for the year 2014-15 is 33% to 67%. For the first time urban clientele has outstripped the rural clientele of MFIs.

CONCLUSION

The importance of microfinance in the developing countries like India can not be undermined it play a vital role for socio-economic upliftment of poor and low income peoples. Since 1990s, poverty reduction has taken priority at both national and international development levels. Within this framework, various initiatives have been taken by government. Microfinance has caught the attention as an effective tool for poverty reduction and socio-economic development. Hence Microfinance can play a vital role for improving the standard of living of poor.

The economic development of any country is severely influenced by the availability of financial services. Microfinance is the form of a broad range of financial services such as deposits, loans, payment services, money transfers, insurance, savings, micro-credit etc. to the poor and low income individuals. A well developed financial system promotes investment opportunities in an economy. Therefore it is necessary that govt. of India have to focus on extending financial services to both rural and urban to ensure sustainable and inclusive growth.

From the above study it can be viewed that SHG’s and MFI’s are playing a vital role in delivery of microfinance services which leads development of poor and low income people in India. However, slow progress of graduation of SHG members, poor quality of group functioning, dropout of members
from groups etc., have also been reported various study findings in different parts of the country, which need to be taken into account while designing the road map for the next phase of the SHG programme.

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