Micro Finance in India- An Analysis

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Abstract

The major concern of Indian economy is to spread the benefits attained through economic growth to all sections of the society. Despite encouraging policies and having a wide network of rural branches in India, a very large number of the poorest of the poor continue to remain outside the field of formal banking system. Microfinance is still an evolving sector in India as compared to many developed countries. Microfinance helps in the socio-economic development of poor and low-income countries of women and men throughout the world. The present paper highlights the origin and growth of microfinance in India. It examines progress and coverage of SHG- Bank Linkage Model and Microfinance Institution Model in India. The study also identifies challenges in the way of microfinance and give recommendations to overcome them. The present study is descriptive and analytical in nature. The study is based on secondary data. The study traces the progress of SHG-Bank Linkage Model and Microfinance Institution Model from 2009-10 to 2011-12. The Indian microfinance sector has made tremendous strides during the last decade. The greatest barrier is that of regional imbalances in client outreach, loan portfolios and distribution of branches among various regions in India. The various challenges need to be addressed and would go a long way in making the Indian microfinance sector more inclusive, vibrant and sustainable. It can be concluded that microfinance has effectively graduated from an experiment to a widely-accepted paradigm of financial inclusion in India.

Keywords: SHG-Bank Linkage Model, Microfinance Institution Model, Indian Economy, Financial Inclusion

Introduction

The major concern of Indian economy is to spread the benefits attained through economic growth to all sections of the society. Focus of the government is on the upliftment of the poor strata of the society. Despite encouraging policies and having a wide network of rural branches in India, a very large number of the poorest of the poor continue to remain outside the field of formal banking system. Banks are still not able to serve a vast section of the society. In fact proportion of the informal money lenders has increased over the years. The share of formal financial sector in total rural credit was 56.6% compared to informal finance at 39.6%. Not only had formal credit flow has been less but also uneven.

The failure of India's rural banks to deliver finance to the poor may be attributed to large number of factors. From the bank's perspective, serving the rural poor is high risk affair due to uncertainty about the repayment capacity, high transaction costs, frequent transactions and government policies which contribute to a non-conducive financial climate to rural banking. From the poor rural borrower's perspective, banks do not provide conveniently accessible and flexible services, involves costly and cumbersome procedures. Long processing times and lack of collateral securities also act as major hurdle.

With a view to developing supplementary credit delivery mechanism, the Self Help Group (SHG)- Bank Linkage Model was introduced by NABARD in 1992 as the core strategy that could be used by the banking system in India for increasing their outreach to the poorest of the poor. Microfinance is still an evolving sector in India as compared to many developed countries. Those who promote microfinance generally believe that such access will help poor people out of poverty. Microfinance helps in the socio-economic development of poor and low-income countries of women and men throughout the world. The present paper examines the progress of microfinance in India.

Objectives of the Study

- To study the origin and growth of microfinance in India.
- To examine progress and coverage of SHG Bank Linkage Model and Microfinance Institution Model in India.
- To identify challenges in the way of microfinance and give recommendations to overcome them.

Methodology and Database

The present study is descriptive and analytical in nature. The study is based on secondary data. The data is collected from various publications, print and electronic of government and non-government agencies such as National Bank of Agriculture and Rural Development, Reserve Bank of India. The study traces the progress of SHG-Bank Linkage Model and Microfinance Institution Model from 2009-10 to 2011-12. The study also does coverage analysis of SHG and MFIs in terms of client outreach, loan portfolio and distribution of branches

Concept of Microfinance

Microfinance is the provision of broad range of financial services such as deposits, loans, payment services, money transfers and insurance products to the poor and low-income households for their microenterprises and small businesses to enable them to raise their income levels and improve their living standards. Microfinance is seen as a tool to reach the poorest section of society and to provide them with services and resources that will uplift their economic well -being.

Over the past decade, microfinance has taken on an increasingly significant role in the developing economies as microfinance refers to a credit loan less than $ 100. The United Nations had officially proclaimed the year 2005 as the 'International Year of Micro Credit'

Origin and Growth of Microfinance in India

The birth of microfinance movement in India can be traced to 70s. The main aim of the movement was to alleviate poverty by delivering financial services to the poor. The basic idea was to enable poor to access the financial services so that poor can have an asset base and initiate income generation activities. Self Employed Women Association (SEWA) is considered one of the pioneers of the microfinance movement in India. Over the years, the efforts of these organizations have proved that poor are bankable. Further, in the last two decades microfinance movement has gained a lot of prominence world over and also in India. Microfinance movements in India can be divided into two distinct phases: from 1970s to 1991and Phase II from 1991 to the present time. In the Phase II, formal financial sector in India also joined the microfinance movement.

The first official interest in an informal group lending in India took shape during 1986-87 on the initiative of NABARD. NABARD initiated certain research projects on Self- Help Groups (SHGs)

as a channel for delivery of microfinance in the late 1980. Amongst these the action research project sponsored by Mysore Resettlement Credit Management of SHGs was partially funded by NABARD in 1986-87.

Microfinance by non-formal financial organizations can be traced to the initiative undertaken by the Self- Employed Women's Association (SEWA), owned by women of petty trade groups for providing services to the poor women employed in the unorganized sectors of Ahmedabad. Sri Mahila Sewa Sahkari Bank was set up by registering it as an urban cooperative bank. Since then, the bank has been providing banking services to the poor and self -employed working as hawkers, vendors, domestic servants etc. Sreyas in Kerala actively got involved in microfinance operations since 1988 with the objective of promoting people's co-operative habits of thrift and self -managing people's bank.

RBI and NABARD regulate the microfinance operations of the banking sector as a part of their overall banking operations. The large numbers of women's organizations like SEWA, Working Women's Forum (WWF) were also involved in microfinance activities like group lending. A range of institutions in public sector as well as private sector offers the microfinance services in India. They can be broadly categorized in the two categories namely formal institutions and informal institutions. The former category that provides microfinance services in addition to their general banking activities are referred to as micro finance service providers. On the other hand, the informal institutions that undertake microfinance services as their main activity are generally referred to as Microfinance Institutions (MFIs).

The Indian Microfinance sector is characterized by a variety of microfinance service providers. These include apex financial institutions like the National Bank for Agriculture and Rural Development (NBARD), Small Industrial Development Bank of India (SIDBI) and government owned societies like Rashtriya Mahila Kosh (RMK), formal sector financial institutions, Commercial Banks, Regional Rural Banks, members based institutions like Cooperatives, Mutually Aided Co-operative Societies (MACs), SHG federations, Private sector companies, specialized Non-Banking Financial Corporations (NBFCs), Societies, Trust etc.

At present there are two main models of microfinance delivery system in India. They are SHG Bank Linkage Programme Model and Micro Finance Institution Model. About 87 percent of the poorest households do not have access to credit. The demand for microcredit has been estimated at up to $ 30 billion, the supply is less than $ 2.2 billion combined by all involved in the sector.

Demand for Microfinance Services in India

Typical microfinance clients are poor and low-income people that do not have access to other formal financial institutions. Microfinance clients are usually self-employed household based entrepreneurs. In terms of demand for microfinance services there are three market segments:

- Those who are landless and engaged in agricultural activities on a seasonal basis and manual labourers in forestry, mining, household industries and construction.
- The next segment is small and marginal farmers, rural artisans weavers, self-employed informal sectors such as hawkers, vendors and workers in household micro enterprises.
- The third segment is of small and medium farmers who have gone in for commercial crops and others engaged in dairy farming, poultry, fisheries etc. and non-farm activities such as tea shops, provisional stores and other manufacturing activities.

Progress of SHG- Bank Linkage Model & Microfinance Institutions Model

SHG-Bank Linkage Model: SHG-Bank Linkage Model was launched by NABARD in 1992. It is an important strategy in promoting financial inclusion and inclusive growth. Under the SHG Model the members, usually women in villages are encouraged to form groups of around 10-15. The members contribute their savings in the group periodically and from these savings small loans are provided to the members. The group members meet periodically when the new savings come in, recovery of past loans are made from the members and also new loans are disbursed. SHG has been recognised as a decentralised, cost effective and fastest growing microfinance initiative in the world enabling over 103 million poor household's access to a variety of sustainable financial services from the banking system by becoming member of a nearly 8 million SHGs. The small beginning of linking only 500 SHGs to banks in 1992 had grown to over 0.5 million SHGs by March 2002 and further to 8 million SHGs by March 2012.

Studies conducted by various experts show that programme has indeed helped in the social and economic empowerment of rural folk especially women. It has resulted in significant up-scaling of social capital while at the same time delivering crucial financial services. Thus it has proved to be a successful model wherein the outreach has expanded substantially leading to many advantages like micro savings, timely repayment of loans, reduction in transaction costs to SHG members and banks etc.

Table 1: Overall Progress under SHG-Bank Linkage as on 31st March

(Amount Rs. in Cr/ Number in Lakh)

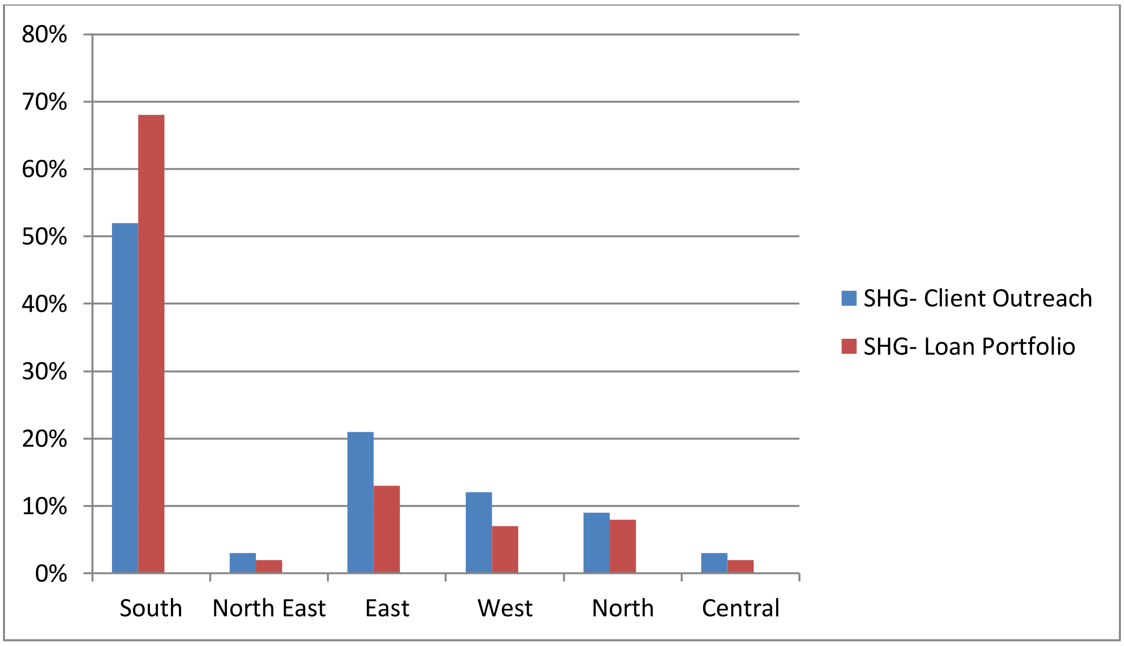
Particulars/Year	2009-10		2010-2011		2011-2012	
	No of SHGs	Amount	No of SHGs	Amount	No of SHGs	Amount
Total SHG Savings with Banks	69.53 (13.6%)	6198.71 (11.8%)	74.62 (7.3%)	7016.30 (13.2%)	79.60 (6.7%)	6551.41 (-6.7%)
Loans Disbursed to SHGs during the year	15.87 (-1.4%)	14453.3 (17.9%)	11.96 (-2.46%)	14547.73 (0.01%)	11.48 (-4%)	16534.77 (13.7%)
Loan Outstanding against SHGs	48.51 (14.8%)	28038.28 (23.6%)	47.87 (-1.3%)	31221.17 (11.4%)	43.54 (-9.0%)	36340.00 (16.4%)

Source: Status of Microfinance in India, NABARD, 2011-12.

Table 1 indicates the progress of SHG-Bank Linkage Model. The number of saving linked SHGs now stands at 79.60 lakh with a membership of over 103 million poor households. Over 79% of SHGs linked to banks are exclusive women groups which is one of the most distinguishing features of microfinance sector in the country. The balance in the saving accounts of the banks as end of March 2012 stood at Rs. 6551.41 Cr. Loans disbursed to SHGs has increased from Rs. 14453.3 Cr in 2009-10 to Rs. 16534.77 Cr in 2011-12 whereas number of SHGs has declined from 15.87 lakhs to 11.48 lakhs over the same time period. Loan outstanding against SHGs has also increased from Rs. 28038.28 Cr in 2009-10 to Rs. 36340.00 Cr. in 2011-12. Thus, programme exhibited significant growth in terms of coverage and outreach of credit to the rural poor.

SHG Coverage Analysis: SHG- Bank Linkage Model shows a pattern of regional imbalances. Chart 1 indicates that Southern state have a large stake about 52% in client outreach and 68% in loan portfolio through SHG (Credit Linked) Programme. Eastern states account for 21% of client outreach and 13% of loan portfolio whereas Western and Northern states seem to be promising in carrying forward the programme but North-Eastern and Central states have again recorded a poor performance in terms of client outreach and loan portfolio.

Chart 1 SHG- (Credit Linked) Client Outreach & SHG- (Credit Linked) Loan Portfolio



Source: IFMR Centre for Microfinance Research, Map of Microfinance Distribution in India, 2010.

Microfinance Institutions Model (MFIs): MFIs act as an important conduit for extending financial services to the microfinance sector in the country by raising resources from Banks and other institutions. MFIs could be i) NGO MFIs- registered under the Societies Registration Act, 1860 or the Indian Trusts Act, 1880 ii) Co-operative MFIs- registered under the State Co-operative Societies Act or Mutually Aided Co-operative Societies Act or Multi State Co-operatives Societies Act. iii) NBFC MFIs incorporated under Section 25 of Companies Act, 1956 (These NBFC's are working "not for profit") iv) NBFC MFIs incorporated under the Companies Act, 1956 and registered under RBI.

A number of organizations with varied size and legal forms offer microfinance service. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising 5 to 10 individual members who come together for the purpose of availing loans either individually or through the group mechanism against mutual guarantee.

There are some positive aspects to the rapid expansion of MFIs. First, geographic expansion can result in greater availability of microfinance services and choice for the customers. A number of MFIs have expanded into adjoining urban areas and are catering to the urban poor, who are also often in need of microfinance. Another positive aspect is that larger scale of MFIs enables greater use of technology.

A number of MFIs are now computerizing their MIS systems so as to have better control over operations and manage their resources better. However, the sector is dominated by a few large MFIs. It is estimated that MFIs incorporated as NBFCs, which are around 30 in number, account for 70 percent of MFI loan

Table 2: Progress under MFI Bank Linkage Model (Rs. Cr)

Particulars/ Year	2009-10		2010-11		2011-12	
	No. of MFIs	Amount	No. of MFIs	Amount	No. of MFIs	Amount
Loans disbursed by banks to MFIs	779 (34%)	10728.50 (187.4%)	471` (-39.5%)	8448.96 (-21.3%)	465 (-1.3%)	5205.29 (-38.39%)
Loans outstanding against MFIs as on 31st March	1659 (_13.4%)	13955.75 (178.6%)	2315 (39.5%)	13730.62 (-2.0%)	1960 (-15.3%)	11450.35 (-16.6%)
Fresh loans as % of loan outstanding		76.9		61.5		45.5

Source: Status of Microfinance in India, NABARD, 2011-12.

Note: Actual number of MFIs availing loans from Banks would be less than the figures shown as most of MFIs avail loans from more than one bank.

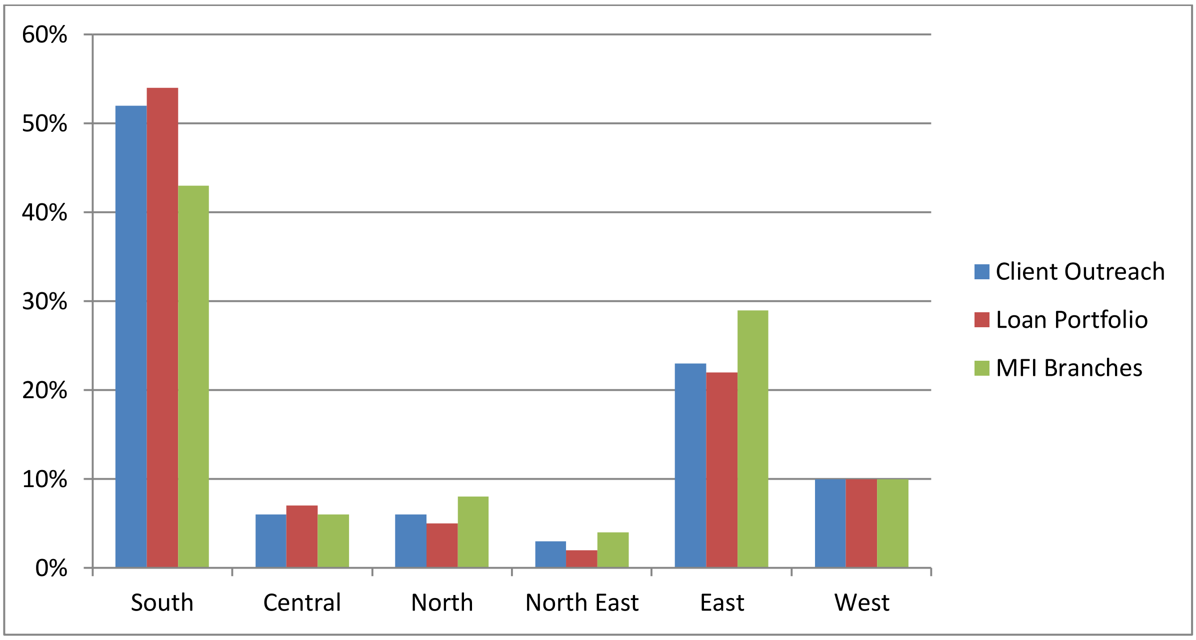
From table 2, it is clear that loan disbursed to number of MFIs has declined from 779 in 2009-10 to 465 in 2011-12. Amount of loan disbursed has also declined from Rs. 10728.50Cr. to Rs. 5205.29Cr. Fresh loans as percentage of loans outstanding have also declined from 76.9 percent in 2009-10 to 45.5 percent in 2011-12. The decline in fresh lending to MFIs by banks, clearly shows that commercial banks are losing their confidence in lending to MFIs. There has been marginal decline in the number of MFIs availing fresh loans from banks inspite of the fact that the loan outstanding against MFIs has come down by almost 17 percent during the year. If the trend continues, this sector is likely to face serious resource crunch and could affect its outreach plans in near future.

The major cause of this trend was the recent developments in Andhra Pradesh, the cradle of microfinance in India which had stamped the future of the sector with the question mark. Andhra Pradesh was engulfed by a spate of close to 30 farmer suicides allegedly linked to coercive collection methods of MFIs. These developments resulted in Andhra Pradesh Government promulgating an ordinance to severely restricting their lending operations and recovery mechanism. As a result, the lending operations of these institutions virtually come to halt not only in Andhra Pradesh but also in other areas as well.

MFI Coverage Analysis: MFIs in India experienced phenomenal growth increasing number of clients reached by 66 percent CAGR and total loan portfolio above 100 percent CAGR. Despite this growth, regional penetration has emerged as a challenge for the sector. The data collected from

MFIs across India reveals that Southern states continue to dominate the industry in terms of MFI presence and coverage. Chart II shows region-wise client outreach, region-wise loan portfolio and distribution of MFI branches

Chart 2 Region-wise Client Outreach & Loan Portfolio of MFIs and Distribution of MFI Branches



Source: same as Chart 1

Chart 2 clearly shows that more than half (52%) of the active clients of the industry belong to the Southern states while almost one quarter (23%) belong to the Eastern states, Western states contribute to 10 % to the total client base and Central and Northern States contribute to 6% each. The North-eastern states seem to be the most underserved region of the country responsible for meagre 3 % of total number of clients. A similar trend is also seen in loan portfolio- the Southern states contributing 54%, Eastern states 22%, Western states 10%, Central states 7%, Northern states 5% and North eastern states only 2%. The distribution of MFI branches exposes a related trend. MFI rarely travel a long distance to overcome regional imbalances in their client outreach and coverage.

Impact of Microfinance on Poor in India

Microfinance plays a very important role and it had following impact on the poor:

- Microfinance has reduced incidence of poverty. It provides a range of benefits that poor household highly value including long term increases in income and consumption.
- Microfinance helps in increasing the financial self- sustainability among the poor. Access to credit helps the poor to smooth cash flows and develop in them habit of savings.
- Microfinance contributes towards women empowerment. It enhances their contribution to household income and generally gives them better control over decisions affecting their lives.
- Microfinance has led to better education and improved health facilities. Families participating in the programme have reported better school attendance and lower drop- out rates. Child mortality has reduced and maternal health has improved.
- Microfinance has lessened social evils like child marriage, child labour, dowry and other anti-social activities.
- Microfinance has developed various entrepreneurial skills among rural and urban poor.

- It has saved especially rural poor from the clutches of the village moneylenders.

Challenges in way of Microfinance

The Indian Microfinance sector has seen unprecedented growth in this decade. The growing scale has brought with its own set of challenges. Some of the key challenges are:

- ***Widening outreach:*** One of the fundamental principles of microfinance is serving a large number of clients. It is very important to analyze if microfinance service providers are reaching down to those most in need and those not serviced by formal financial institutions. There are regional imbalances in spread of MFIs. State governments have to play a significant role and found out reasons for low outreach.
- ***Financial illiteracy:*** One of the major obstacles in the growth of the microfinance sector is the financial illiteracy of the people. This creates difficulty in creating awareness about microfinance. It also creates greater difficulty of serving poor illiterates as microfinance clients.
- ***Credit risk:*** There is danger that borrowers are not able or not willing to repay their loans on time. In other words, there is greater risk in deterioration of the loan portfolio. In order to overcome this problem, people's mindset has to be changed.
- ***Legal & regulatory framework:*** Currently there is no proper regulatory body for the supervision of MFIs. Many SHGs and microfinance institutions neither have effective internal control systems nor do they have incentive to put such systems in place. There is a need of setting up enabling legal and regulatory framework.
- ***High Administrative Costs:*** The increasing administrative costs of SHGs must be reduced properly by various methods including setting up the performance levels in advance, proper business planning, removal of political favoritism and corruption etc.
- ***Inability to generate sufficient funds:*** Inability of MFIs to raise sufficient fund remains one of the important concerns in the microfinance sector. MFI sector largely comprise of not-for-profit companies which mainly rely on donations and grants from Government and apex institutions like NABARD and SIDBI. In absence of adequate funding from the equity market, the major source of funds for MFIs are the bank loans due to which most of MFIs has high debt to equity ratio.
- ***Over-Indebtedness:*** Due to competition among MFIs and capturing each other's market share, MFIs are giving multiple loans to same borrowers. This in some cases lead to over-indebtedness of the borrower. MFIs are getting affected because borrowers are failing to

make payments and hence their recovery rates are falling. Over-Indebtedness in some cases may force borrowers to commit suicide.

- ***Other challenges:*** The training of large number of stakeholders, maintaining the quality of groups also poses a big challenge. Further ensuring poor book keeping at the SHG level, innovations in savings and credit products, graduation from livelihood enterprises to economic enterprises establishing market linkages for products by members of SHGs are some other problems being faced which need to be tackled properly.

Recommendations

All the members of the Self -help groups are not equally educated so they may not have the same level of understanding capacity. NGOs should play a significant role in providing basic education and training.

- There exists huge demand-supply gap. Diverse channels are needed to get diverse financial services into the hands of diverse range of people who are currently excluded.
- Government should try to organize small fairs at regular intervals of time to market the products produced by the members of SHGs.
- Most of MFIs are operating in urban and semi-urban areas. MFIs should be encouraged for opening new branches in areas of low microfinance penetration by providing financial assistance. This will help in increasing rural penetration.
- Proper monitoring and regulatory framework should be initiated which will put check on the performance of MFIs and will encourage MFIs to abide by proper code of conduct and work more efficiently.
- Usage of technological innovations in MFIs will help to reduce operating costs and will make the entire system more transparent and efficient.
- Integrated network of banks, governments, semi-governmental or non-governmental organizations, social workers are needed to make microfinance a great success.

Conclusion

The Indian microfinance sector has made tremendous strides during the last decade. SHG-Bank Linkage programme has also grown rapidly and is considered as the single largest microfinance programme globally. Microfinance is seen as a tool to reach the poorest section of the society and to provide them with services and resources that will uplift their economic well-being both in India as well as at global level. The greatest barrier is that of regional imbalances in client outreach, loan portfolios and distribution of branches among various regions in India. The various challenges need to be addressed and would go a long way in making the Indian microfinance sector more inclusive, vibrant and sustainable. Microfinance is the most effective way to achieve the goal of financial inclusion because it distributes credit in a more democratic way to the poor masses. It can be concluded that microfinance has effectively graduated from an experiment to a widely-accepted paradigm of financial inclusion in India.

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