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MICROFINANCE IN INDIA: PERFORMANCE, PROBLEMS & POLICY

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ABSTRACT

Microfinance has become a medium of including financially excluded and unbanked poor population. In India, microfinance has also acted as an effective tool for fighting against poverty In the present scenario, even though MFIs hold the largest share of loan portfolio, banks have been successful in registering stable growth mainly due to important factors like easy accessibility to funds, higher loan ticket size and low delinquency ratios in the Indian microfinance scenario. The Microfinance sector in India faces several challenges like low level of financial literacy, over-dependence on the banking system for funds, higher interest rates and exclusion of the really poor population. However, this sector has the potential to uplift the poor and contribute to India's aim of becoming a USD 5 trillion economy by 2025. This paper defines microfinance, analyses the current status of microfinance sector in India, identifies the challenges and suggests measures to tackle existing challenges in the microfinance sector in India.

KEYWORDS: ***microfinance, MFIs, financial inclusion, microcredit, India***

INTRODUCTION

Despite impressive growth and evolution of the banking industry, institutional credit still remains largely inaccessible to the rural poor. Even after seventy years of independence the existing formal financial institutions in the country have been unsuccessful in ensuring equitable distribution of credit to the needy. The formal financial sector still lacks confidence in the ability of poor in uplifting themselves through self-employment. They are still not considered creditworthy by the financial institutions.

Thus, in order to provide credit to poor households with limited to access to banking services, microfinance was introduced around the eighties. Currently, the global microfinance industry is worth over INR 8.90 trillion and the loan disbursed amount is growing at an average annual rate of 11.5% over the last 5 years. The industry benefits the lives of 139.9 million borrowers worldwide, 80% of whom are women and 65%, from a rural background (Microfinance Barometer Report 2019).

In India, microfinance is considered as an effective instrument in eradicating poverty by helping rural poor access formal financial institutions. The Micro Finance Institutions (MFIs) are provided financial resources by the banks and other mainstream financial institutions which in turn is used by them to reach financial services to the rural poor. Despite consistent efforts, more than 50 % of the rural households are deprived of formal credit. Thus, Microfinance can contribute a lot in the development process of the Indian economy by providing credit access to these poor households. Inclusion of these poor into the formal financial system can empower and uplift the poor economically and socially.

This sector has played a significant role in providing formal credit to the underserved low-income households and micro, small and medium enterprises (MSMEs), thus, inflating the share of these sectors in India's overall GDP. This sector registered a growth of 40% in terms of loan portfolio in the year 2019 (SIDBI, 2019). This sector is expected to maintain such growth rate with the support of improved technology, development of regulatory policies, new partnerships and launch of diverse products. Increasing support from the Govt of India and Reserve Bank of India has helped the sector in expanding and reaching newer locations. Microfinance becomes necessary for economic growth of a large section of unbanked and undeserved poor households by making all financial products accessible to them. Bringing this unbanked population within the reach of financial services will contribute greatly to the aim of India becoming a 5 trillion USD economy by 2025. This paper defines microfinance, analyses the current status of microfinance sector in India, identifies the challenges

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and suggests measures to tackle existing challenges in the microfinance sector in India.

OBJECTIVES

- To define the concept of microfinance,
- To analyse the current status of microfinance sector in India,
- To identify the constraints and challenges faced by microfinance sector in India,
- To suggest strategies to overcome aforementioned challenges.

DATABASE AND METHODOLOGY

The study is descriptive in nature and is based on previous studies including books, journals, articles, newspaper reports, reports of concerned committees and institutions, research based articles on microfinance published in journals and international best practices, etc. The study has made use of secondary data collected from published reports like Status of Microfinance in India, 2018-19, NABARD, Vision of Microfinance in India, 2019 SIDBI and Microfinance in India, 2016-17, NABARD.

DEFINITION OF MICROFINANCE

Generally, microfinance means financial services targeted for individuals and small businesses that are excluded from the formal financial system. Micro Finance Institution is an entity which provides microfinance services in the form and manner as may be prescribed but does not include a banking company or a co-operative society. Microfinance services means one or more of the following financial services involving small amount to individuals or groups: (i) providing micro credit; (ii) collection of thrift; (iii) remittance of funds; (iv) providing pension or insurance services; (v) any other services as may be specified.

As per the Reserve Bank of India, microfinance means provision of thrift, credit and other financial services and products in very small amounts to the poor in rural, semi-urban or urban areas aimed to provide them with the opportunity to augment their income and thus improve their living standards.

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 poor and low income households and their micro-enterprises.

4. MICROFINANCE IN INDIA: PRESENT STATUS

4.1 SHG-Bank Linkage Programme

This is the largest microfinance programme of the world. In 1992 NABARD had started the Self Help Group-Bank Linkage programme (SHG-BLP) to deliver affordable door-step banking services. It covers more than 12 lakh households through more than 100 lakh Self-Help Groups that possess deposits worth Rs 23,000 crore annual loan offtake of more than 58000 crore and loan outstanding of over Rs 87000 crore (NABARD, 2018) of which, 88% was disbursed to rural women groups (up to 31 March 2019). The growth during 2018-19 remained steady and promising. It has contributed to empowerment of poor, especially rural women. Nevertheless, it is also faced with many issues like uncertainty in bank loans, smart book keeping, limited adoption of technology and declining advantage of aggregation at SHG level etc

Table 1. Status of SHG-BLP in 2018-19 (Agency-wise)

(Amount in Rs lakhs)

Particulars	Total Savings of SHGs with Banks as on 31 March 2019		Loans disbursed to SHGs by Banks during 2018-19		Total Outstanding Bank Loans against SHGs as on 31.03.19		NPAs as on 31.03.19	
	No. of SHGs	Savings Amount	No. of SHGs	Loans disbursed	No. of SHGs	Loan Outstanding	Amount of Gross NPA	NPA (percent)
Commercial banks	5476914	1324023.23	1512907	3449246.74	2901209	5564111.05	289739.17	5.21
Regional Rural Banks	3078473	769201.27	940818	1955264.43	1695534	2619598.85	127482.95	4.87
Cooperative Banks	1458856	239223.65	244675	427251.71	480589	526105.53	35178.93	6.69
Total	10014243	2332448.15	2698400	5831762.88	5077332	8709815.43	452401.05	5.19

Source: Status of Microfinance in India, 2018-19, NABARD.

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Table 2. Progress of SHG-BLP (2016-17 to 2018-19) (No. of SHGs in lakh/Amount in Rs '000 crore)

Year	No. of SHGs with Savings Linkage	Amount of Savings Outstanding	No. of SHGs availed Loans during the year	Amount of Loan Disbursed during the year	No. of SHGs with Loan Outstanding	Amount of Loan Outstanding
2016-17	85.77	16.11	18.98	38.78	48.48	61.58
2017-18	87.44	19.59	22.61	47.18	50.2	75.6
2018-19	100.14	23.32	26.98	58.32	50.77	87.1

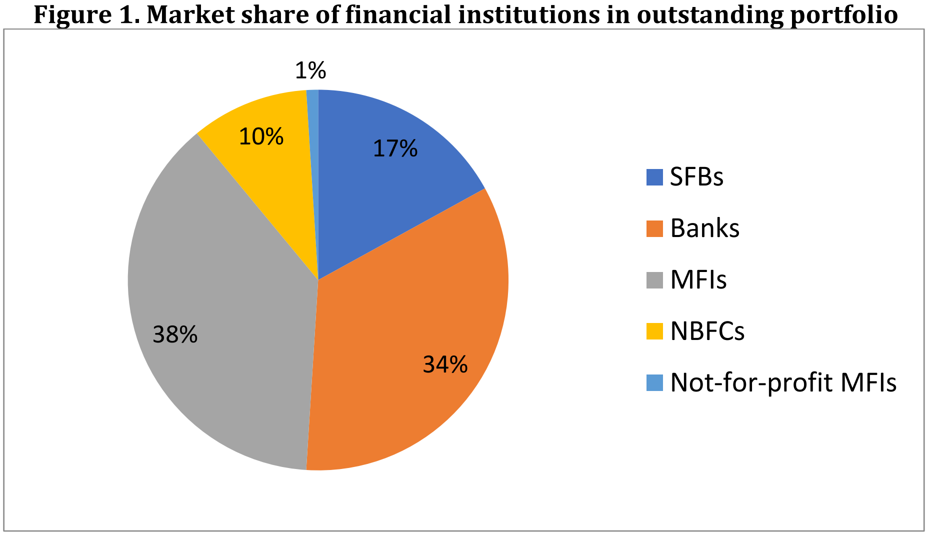
Source: Status of Microfinance in India, 2018-19, NABARD.

As on March 2019, 100.14 lakh SHGs have savings accounts linkage covering more than 1200 lakh households and aim to empower the rural poor (especially women) socially, economically and financially. Between 2016-17 and 2018-19, there had been a positive trend in the number of SHGs having savings bank accounts, amount of credit disbursed, outstanding bank loans and the amount of savings outstanding. SHGs availing loans from banks grew by 19.33 percent while the amount of loans advanced to these SHGs increased by 23.6 percent during 2018-19. During the same year, there has been an addition of 12.70 lakhs SHGs with savings linkage increasing the figure from 87.44 lakhs to 100.14 lakhs. Within the country, some regions have registered good growth in savings accounts of SHGs while some regions have registered negative growth due to data sanitization, closure of dormant accounts, under reporting for certain states, and change in the SHG Bank Linkage model

4.2 Microfinance providers in the Indian lending landscape

In India, microlending is conducted by many different agencies like commercial banks, Self-Finnacing Banks (SFBs) Microfinance Institutions (MFIs) Non-Banking Finance Companies (NBFCs) not-for-profit MFIs. And among these players, MFIs hold the largest share of loan portfolio standing at Rs 681 billion and accounting for 38% of the total industry portfolio. It implies that most borrowers prefer to take loans from MFIs.

Figure 1. Market share of financial institutions in outstanding portfolio



Source: Vision of Microfinance in India, 2019, SIDBI.

Even though MFIs hold the largest share of loan portfolio, banks have been successful in registering stable growth mainly due to important factors like easy accessibility to funds, higher loan ticket size and low delinquency ratios in the Indian microfinance scenario. In spite of holding the largest share of the loan portfolio, MFIs have faced adverse effect on their growth mainly due to limited fund availability and high customer acquisition and servicing costs incurred for operating in remote locations. Consequently, the rates offered by the MFIs may range from 24% for larger NBFC-MFIs to 35–45%10 for smaller MFIs, making difficult to afford for the end customers and producing large NPAs for microfinance providers.

CHALLENGES FACED IN THE MICROFINANCE SECTOR

A study by Sriram (2016) has shown that the microfinance sector in India is growing at an unhealthily fast rate. Loan portfolio/advances have increased rapidly in the recent years while the

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supporting resources have increased at a comparatively lower rate. Loan portfolio has increased substantially while the clients, staff and branches have increased at a lower rate meaning more and more loans are advanced to the same clients and through same branches. This mismatch can result in large-scale defaulters.

1. Financial illiteracy: The growth of microfinance sector faces another major challenge in the form of financial illiteracy making it difficult to create awareness regarding microfinance and serve them as microfinance clients. Majority of the rural poor in the country are still financially illiterate. It becomes a challenge to convince them about newer forms of financial services and even a more challenging task to serve them as clients.

2. Asymmetric Information: there are very less existing credit information sources about small borrowers in rural areas. Most of the rural borrowers depend on informal money lenders who prefer not to share the good repayment record of borrowers with other credit delivery agencies. This creates lack of information on rural borrowers which hinders the growth of microfinance in rural areas.

3. Financially dependent MFIs: Another important challenge is the inability of MFIs to raise sufficient fund in the microfinance sector. Several studies have found that agencies serving the poor borrowers are usually financially dependent on donor organisations for establishment, technical assistance and sometimes even for business operations (Satish, 2005). In India, MFIs largely depend on commercial banks and the banking industry for funds. Since majority of MFIs in India are registered as NGOs, they depend on the traditional banks for funds to conduct their own lending operations. They are mostly funded by private banks who charge higher interest rates. This over-dependence on the banking system (Nair, 2011) has made these MFIs less serious towards defaults and unsustainable.

4. Deserving Poor are not served: In an effort to conduct the scheme successfully and to maintain good repayment rates, the operators tend to select economically stable individuals as the beneficiaries. Doing so, excludes the real deserving poor and are benefitted to only some extent.

5. Low Outreach: In India, outreach of microfinance is as low as 8% as compared to 65% of Bangladesh. Micro credits advanced to the rural population are quite small in amounts and are usually for less than a year making it difficult to use the funds for productive purposes.

6. High Interest Rate: another important challenge hindering the growth of microfinance is the high interest rates charged by the MFIs (Mitra, 2009) which become very difficult for the poor to pay. High interest rates discourage the poor from borrowing even for productive purposes. The interest rates charged by the MFIs in India are higher than the commercial banks thus limiting their financial success.

7. **Regional Imbalances**: There is unequal geographical growth of Microfinance institutions (Jain & Jain, 2014) and SHGs in India. The coverage of the programme is low in states like Orissa, Bihar, Jharkhand, Chhattisgarh, Madhya Pradesh and Uttar Pradesh where the percentage of poor population is large. About 60% of the total SHG credit linkages in the country are concentrated in the Southern States.

MEASURES TO OVERCOME THE CHALLENGES

Efforts should be made to improve people's accessibility to microfinance in both rural and urban areas. The regulations also should be to support the growth of this sector rather than restraining it. There should be the provision of basic training for the rural and urban poor on how to use these loans for productive purposes.Some important measures for tackling the existing challenges faced by the microfinance institutions in India are mentioned below.

1. **Improved Regulatory Framework**: Microfinance sector which has been growing steadily since last few decades needs a proper regulatory framework that protects the interest of all stakeholders. Savings mobilisation have been increasing in the microfinance industry (Satish, 2005). Thus, in the absence of a proper regulatory framework, dishonesty and corruption might creep into the industry to prey upon the poor's hard-earned money.

2. **Encourage Rural Penetration** MFIs prefer to open new branches in areas where other MFIs are doing well rather than reaching new locations. They are interested in running the programme smoothly and maintain proper recovery rate (Dhar, 2016). MFIs should, actually be encouraged to reach places with lower microfinance reach and provide financial services to the needy.

5. **Transparency of Interest Rates** MFIs charge different rates of interest for different loan sizes and some of tehm charge additional charges and interest free deposits. Such approach makes the pricing non-transparent and discourages the borrowers as they are price-takers. This necessitates for a transparent interest rate system.

6. Adoption of technology: Use of improved technology and ICT can help the MFIs reduce their operating costs. Thus, MFIs have to be supported and encouraged to use cost-cutting technologies to reduce their operating costs. There have been instances of MFIs using mobile phone technology to reach the poor borrowers in remote locations.

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CONCLUSION

Microfinance has proved to be an important tool in improving the living conditions of millions of the country's population. Provision of microcredit to the capital-poor through microfinance can contribute to creation of gainful employment. Even though the microfinance sector has grown much in the recent times with multiple players in this sector, a significant portion of the country's population still fall in the low-income band. This provides a great scope for the growth of the microfinance sector in India. Newer innovations have to be developed to tackle the problems faced by the poor. Government schemes and existing formal financial institutions provide micro credit services to around 67 percent of the rural population. On the other hand, MFIs are found to be concentrated in some regions of the country as compared to other regions indicating higher scope for further growth of this sector in India. So, to make use of this opportunity, the challenges within the industry have to be identified and addressed with relevant measures. Like any other important sector of the economy, the microfinance sector also is faced with several challenges in a developing country like India. These challenges have to be addressed first to enable the microfinance industry to play a significant role in uplifting lives of millions of poor households and contribute to India's aim of becoming a USD 5 trillion economy by 2025.

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