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An analysis of microfinance system in India

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Abstract
Microfinance is gaining importance worldwide as an important measure to alleviate poverty and improve the socio-economic condition of the poor, marginalised and the deprived section of the country. The microfinance sector in India has progressed very well and contributed to the economic upliftment of the people. SHGs and MFIs both are working towards fulfilling the financial needs of rural and urban poor. However, due to some challenges the growth and spread of microfinance system have been obstructed. India can take some lessons from Bangladesh, the pioneer in the microcredit system on how to make microfinance an effective tool in fulfilling the financial needs of the poor, along with promoting the economic growth of the country and welfare of the people. The paper analyses the structure and growth of the microfinance system in India and the challenges faced. It makes an attempt to provide suggestions for enhancing the efficiency of the microfinance system.

Keywords: Microfinance, SHGs, MFIs, challenges, welfare

Introduction
Microfinance has been regarded as an effective tool in alleviating poverty through income generation and contributing to inclusive growth which results in the development of the economy. The Indian economy has been striving hard to achieve the status of the global leader. Since independence, various government plans have been developed and policies are implemented to attain this goal. Economic growth has been accelerated but with the co-existence of many problems such as poverty, unemployment, population explosion, inequality etc. which, in the course of development, aggravated all the more. It was envisioned initially, that the growth of the economy would create a trickle-down effect and hence, all the areas, sections and people would prosper as a result. But the expectations are not met and 29.2% of the population is still living below the poverty line, unable to meet the basic necessities of life (Rangarajan Committee, 2014) [11]. Thus the theory of development from top to bottom has not achieved considerable success and a need arises to initiate development from the very base of the economy. As per the census of 2011, about 68.84% of the total population still resides in rural areas whereas the percentage of urban population is 31.16%. According to the Rangarajan Committee in 2011-12 rural poverty was 30.9% and urban poverty was 26.4%. This deprived and disadvantaged section of the economy needs instant attention not only to improve their condition but also for the betterment of the economy and the society. Poverty and unemployment are two woeful problems, which if addressed effectively, can solve all the other socio-economic problems of the country. Microfinance can act as an effective tool to resolve the issues by increasing employment opportunities, generating income and empowering the deprived.

Objectives of the study
1. To study the structure and growth of the microfinance system in India.
2. To bring out various challenges faced by the institutions.
3. To give suggestions to enhance the efficiency of the microfinance system in India.

Review of literature
Basu and Shrivastava (2005) [3] highlight the fact in their study that poor people are not benefited through banks and depend upon alternative sources. To attain the actual aim of a microfinance system it is essential that the poor get the benefits of the system. Kabeer (2005) [6] states that social and economic development is very important and the impact of the microfinance system on this should be analysed.

Pitt and Khandekar (1998) [10] and Khandekar (2005) [7] elucidates that the microcredit system can be highly beneficial for the poor and the woman. They analyse that however, it is not necessary that microfinance would benefit them. Agarwal and Sinha (2010) [1] have analysed different business models adopted by different firms in India and evaluated their performance. Brown, Guin and Kirschenmann (2012) [4] highlight that microfinance institutions are working for their own profit and should provide services to the actual target group. Zohra Bi and Saraf (2013) [15] have studied the growth and performance of MFIs in India, bringing out the fact that good financial performance is essential for sustainability.

Concept of Microfinance

Microfinance provides financial services such as loans, credit, insurance, opening of bank accounts and financial literacy to that section of the economy which do not have access to the formal banking sector. As per Micro Finance Development Strategy 2000 of Asian Development Bank, 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 (ADB, 2012) [2]. According to Van Manen, "Microfinance is banking the unbankable, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, in most cases, because they are unable to offer sufficient collateral (Manen, 2004) [8].

The uneducated, poor and financially illiterate section is the main target of microfinance services due to their inability to suffice the requirement of formal banks for loans such as providing collateral, completing the lengthy procedure of opening a bank account and are also unable to deposit the meagre savings. All this force them to take loans from local money lenders who exploit them by charging exorbitantly high-interest rates on never-ending loans due to their ignorance, giving birth to the vicious cycle of loans and hence, further aggravating their poverty. Microfinance can play a significant role in poverty alleviation by providing the necessary money for agriculture, business and for their unavoidable needs at reasonable interest rates. Microfinance provides small loans, generally, for short tenure without any collateral. The repayment frequency for microloans is higher. These loans are provided to people with low income, aiming to generate income for them, through assisting them in self-employment, agricultural or other business activities. This facility can contribute towards poverty alleviation, women empowerment, improvement in education and health status and thus, in the socio-economic sustainable development of the country.

Microfinance in India

The concept of microfinance, in the present times, has been revolutionised by Mohammad Yunus of Bangladesh in the 1970s, through his Grameen bank. Since then the importance of microfinance has been realised and been adopted worldwide. In India, the self-employed Women's Association (SEWA) of Gujarat took the first initiative towards microfinance in the 1970s. They formed a group of women members to provide financial services to poor women of rural areas in starting their business by providing assistance from SEWA bank, started in 1974. Since then microfinance in India is growing under different models and through various channels and institutions. There are two models of microfinance in India:-

1) Self-help group -bank linkage model:

One of the most popular channels for microfinance in India is the self-help group -bank linkage program. Initially, self-help groups used to collect their savings and disperse small loans to the members; However, the constraint of financial resources didn't let them satisfy all the needs. To overcome this shortcoming, NABARD in 1992 initiated the SHG-bank linkage program, under which the groups are linked to a bank for their financial needs. Self-help groups are formed by 10-15 people, especially those belonging to the lower-income background, to attain common objectives and goals. They pool their savings at regular intervals and through this common fund, they assist the members who need loans. SHGs get loans from banks if they perform successfully for at least 6 months. The table below shows the progress under the SHG-bank linkage program as per NABARD:

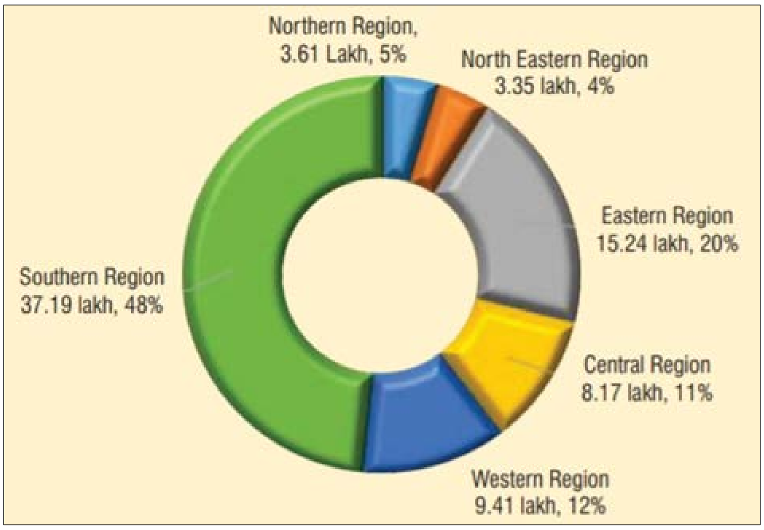
Table 1: Progress under SHG-bank linkage program

(Numbers in lakh/ Amount ₹ crore)

Particulars		2012-13		2013-14		2014-15	
		No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount
SHG Savings with Banks as on 31st March	Total SHG Nos.	73.18 (-8.1%)	8217.25 (25.4%)	74.30 (1.53%)	9897.42 (20.45%)	76.97 (3.59%)	11059.84 (11.74%)
	All women SHGs	59.38 (-5.7%)	6514.86 (27.6%)	62.52 (5.27%)	8012.89 (22.99%)	66.51 (6.38%)	9264.33 (15.61%)
	Percentage of Women Groups	81.1	79.3	84.15	80.96	86.41	83.77
Loans Outstanding against SHGs as on 31March	Total No. of SHGs linked	44.51 (2.2%)	39375.30 (8.4%)	41.97 (-5.71%)	42927.52 (9.02%)	44.68 (6.46%)	51545.46 (20.06%)
	No. of all Women SHGs linked	37.57 (2.9%)	32840.04 (7.8%)	34.06 (-9.34%)	36151.58 (10.08%)	38.58 (13.27%)	45901.95 (26.97%)
	Percentage Of Women SHGs	84.4	83.3	81.2	84.2	86.35	89.05
Loans Disbursed to SHGs during the year	No. of SHGs extended loans	12.20 (6.3%)	20585.36 (24.5%)	13.66 (12.02%)	24017.36 (16.67%)	16.26 (19.03%)	27582.31 (14.84%)
	All women SHGs	10.37 (12.4%)	17854.31 (26.3%)	11.52 (11.02%)	21037.97 (17.83%)	14.48 (25.69%)	24419.75 (16.07%)
	Percentage of Women Groups	85.1	86.7	84.3	87.6	89.05	83.53

Source: Status of microfinance in India 2014-15

It is clear from the table that the number of SHGs is growing. Loans disbursed during the period of 2012 -13 to 2014 -15 have registered an increase. It is also noticed that the percentage of women groups is on a rise which is 81.1% in 2012 -13 and increased to 86.41% in 2014 -15. 48% of SHGs under the program are in the southern region, which is maximum among different regions, whereas the north eastern region is lowest among all with 4% SHGs.



Source: Status of microfinance in India 2014-15

Fig 1: Distribution of SHGs across regions of India 2014-15

2) Microfinance institutions model

Under this model, microfinance institutions provide loans either jointly or individually. Microfinance institutions facilitate various financial services such as loans, savings, insurance and remittance to their clients, who are majorly low-income individuals and groups. Some of the microfinance institutions in India are rural banks, cooperatives and non-government organisations. These institutions are funded by banks to lend the amount to SHGs and other small clients or borrowers. The total loans received by microfinance institutions from banks increased to 32.3% in 2014 -15 as against 31.16% in 2013 -14. The loans outstanding was 26.59% in 2014-15 which was 14.5% in 2013 -14, however, the loan outstanding as a percentage of fresh loans decreased to 148.13% in 2014-15 from 160.64% in 2013-14.

Table 2: Progress under MFI-bank linkage program

(Amount ₹ crore)

Particulars	2011-12		2012-13		2013-14		2014-15	
	No. of accounts	Amount	No. of accounts	Amount	No. of accounts	Amount	No. of accounts	Amount
Loans disbursed by banks to MFIs	465	5205.29	426	7839.51 (50.6%)	545	10282.49 (31.16%)	589	15190.13 [32.30%]
Loans outstanding against MFIs as on 31 March	1960	11450.35	2042	14425.84 (26%)	2422	16517.43 (14.5%)	4662	22500.46 [26.59%]
Loan Outstanding as % of fresh loans		219.98		184.01		160.64		148.13

Source: Status of microfinance in India 2014-15

The Bharat Micro Finance Report 2015 has presented the growth of the microfinance sector in India in the MFI model and SHG model in the following table:

Table 3: Performance of MFIs and SHGs

Indicators: MFI Model	2015	2014	Change
Client Outreach	371 lakh	330 lakh	12.4%
Women Clients	97%	97%	No Change
SC/ST Clients	28%	19%	↑
Other Minorities	18%	14%	↑
Rural Clients	33%	56%	↓
Gross Outstanding Portfolio	₹48882 Cr	₹33517 Cr	45.8%
Income Generation Loan	80%	80%	No Change
SHG Model			
Total No of SHGs Linked	77.12 lakh	74.29 lakh	3.8%
No of Families Reached	101 Million	97 Million	4.1%
Total Savings of SHGs	₹11307 Cr	₹9897 Cr	14.2%
Gross Loan Outstanding	₹51721 Cr.	₹42927 Cr.	20.5%
Total Loan Disbursed	₹30334 Cr.	₹24017 Cr.	26.3%
Avg. Loan Disbursed per SHG	₹184551	₹175769	4.9%
Avg. Loan Outstanding per SHG	₹115295	₹102273	12.7%

Source: The Bharat Microfinance Report -2015

According to The Bharat Microfinance Report 2015, MFIs are working in 528 districts in India serving 371 lakh clients in 2015, registering a growth of 12.4% from 2014. Under the SHG model, 101 million families are reached with a growth of 4.1% from 2014. 80% of the total loan is given for income generation activities out of which the highest 34% is taken for trading and small business and 25% for agriculture. 20% of the loan is disbursed for non-income generation activities under which the highest part is used for consumption, which is 71%. Other than financial services, MFIs have been contributing to developmental services as well. As per the report, 21 MFIs have provided health insurance services, 41 MFIs provided non-health insurance services and 22 MFIs worked for micro pension.

The above analysis elucidates that the microfinance sector is working rigorously towards providing financial services to the underprivileged, lower-income segment of the Indian economy who do not have access to formal banking facilities. The SHGs have contributed immensely to improving the lives of women by making them economically and socially more independent. Microfinance in India, if regulated adequately, can play a major role in poverty alleviation and can address the economic growth from the very bottom of the economy by not only providing finances for employment generation and business but also working towards social and economic development of the deprived section of the society through facilitating services regarding education, financial literacy, water and sanitation, health care, training and capacity building.

Challenges faced by the microfinance sector in India

The microfinance sector has been instrumental, in India, in uplifting the lives of marginalised sections, contributing in increasing their income and ending the cycle of poverty, empowering women and promoting employment. Microfinance is very convenient for the borrowers as they get loans as per their need and convenience and also the repayment plan is decided by them, but the interest charged is higher than the formal banks. Several other challenges are obstructing the growth of the microfinance sector. Some of the challenges are:

1. **Limited outreach:** The microfinance sector has not been able to satisfy the financial needs of the absolute poor. It is felt that there is a higher risk attached with them regarding repayment. Hence, people having higher economic security and stability are selected as beneficiaries so that the repayment rate remains higher and the percentage of NPAs lower.

2. **Higher interest rates:** Microfinance institutions charge higher interest rates on loans than the banking sector. While it ranges between 9-10% annual for traditional banks it is higher for MFIs. The clientele of the MFIs is generally a lower income group and charging high-interest rate is totally unjustified, which makes it very difficult for them to pay this interest. This makes the loans unattractive for poor people.

3. **Overborrowing**: With the increase in the number of MFIs and their clients, the tendency of overborrowing has become prevalent. Many borrowers have tried to take loans from multiple lenders which affect their repayment capacity.

4. **Lower repayment and higher NPAs:** The loans disbursed are generally small in amount and for a short period. Though 80% of the loans are taken for income generation, they are used for consumption. It becomes very difficult to use the meagre amount for productive purposes and hence, they are unable to repay the loan. More loans are taken for the repayment of the previous loans and borrowers are caught in the debt trap, unable to get free from the loans completely. This increases the NPAs of the institutions resulting in obstructed growth since a part of their capital does not come back. In India, the NPA was 7.40% in 2014 -15 under the SHG-bank linkage program (NABARD,2014-15).

5. **Susceptibility to adverse shocks:** The small size of loans and deposits and limited products make MFIs more susceptible to small adverse shocks in the market. They are unable to survive even the smallest of adverse developments which result from political, economic or financial changes or from non-repayment of loans or due to inability to generate finance.

6. **Competition and dependency on banks**: MFIs are highly dependent on banks for finances and it becomes difficult for them to grow independently. Since many banks are dealing in microfinance, they also face competition from banks and are always struggling for their survival.

7. **Uneven spread in states:** The spread of microfinance system is not equal in all the states of India. Andhra Pradesh, Karnataka, Tamil Nadu and West Bengal have the highest number of clients whereas states like Bihar, Uttar Pradesh, Orissa, Madhya Pradesh, Chhattisgarh which have a high percentage of people below the poverty line, lack microfinance facilities.

8. **Financial illiteracy:** Financial illiteracy acts as a major obstacle in the spread of microfinance facilities in India. A substantial part of the clients is illiterate or less educated, with very little financial literacy. This makes the acceptability of microfinance facilities difficult.

Suggestions
The microfinance system has achieved substantial success in India but it can contribute more by overcoming the existing challenges. The foremost attention should be given for making the microfinance facilities available to the people who deserve it the most i.e. to the actual poor, so that the target of achieving growth from the very bottom can be achieved. They should be supported and monitored by the institution for the productive and proper use of the loans so that the loan is repaid on time. Monitoring is also required to control over-borrowing and multiple borrowing. A proper regulatory framework should be designed and implemented for SHGs and MFIs to prevent failures. Microfinance facilities are majorly available in rural areas whereas 26.4% of the urban population is poor. Hence, there is a need to spread the programs and facilities in urban areas as well so that the productivity and potential of the urban population can be channelized towards the growth of the country. It has been witnessed in India that states marked as "poor" do not have adequate microfinance facilities. To end this inequality among various states, it is necessary for state governments to promote such systems and programs. The higher interest rates charged by the microfinance institutions make the loans less attractive for the borrowers and also increase the possibility of non-repayment of the loans. These institutions should not work for profit and hence, should charge competitive interest rates from the clients. Along with providing the facility of loans, savings and other financial services, they should also contribute more towards the welfare of the people through providing education, healthcare facilities, sanitation and drinking water facilities, financial literacy, capacity building and training initiatives. Lack of financial literacy is a major obstacle in the popularisation and adoption of microfinance facilities. MFIs, SHGs, village panchayats and NGOs should work towards improving financial literacy which will not only promote microfinance services but will also contribute to the social and economic upliftment of the people and the country.

Lessons to be taken from Bangladesh
Bangladesh has been a pioneer in the field of microcredit program which was introduced by Nobel laureate Professor Dr Muhammad Yunus in the 1970s, through the Grameen bank. The microfinance sector in Bangladesh has registered tremendous growth since then, with considerable improvement in the economic and social life of the poor people residing in rural areas thus, contributing to higher growth of the economy. Along with increased manufacturing, exports and employment levels, microfinance institutions have also played an important role in bringing about social transformation, alleviating income levels and promoting entrepreneurship in rural areas. More than 75% of the microfinance institutions have been running social development programs majorly concentrating on healthcare, education, women empowerment, water and sanitation etc. All this brought about a remarkable improvement in the income standard, life expectancy, mortality rate, literacy rate, women empowerment and health of the people. Women have played a key role in microfinance development in Bangladesh and this development has resulted in women empowerment as well. In India, though in 2014 -15, 86.41% SHGs having savings with banks are women groups only a very few are offering development services. The aim of the microfinance institutions in India should be the overall development of the people and the country, be it social or economic. The income level and employment status can be enhanced through financial services but improved social indicators and economic welfare can be achieved through education, better health, water and sanitation facilities, women empowerment, skill development, training facilities etc. The basic objectives of the MFIs and SHGs have to be revamped and institutions should not only work for the economic profit but also for the welfare of the community, society and country.

Conclusion
The microfinance sector in India has registered remarkable progress in the number of clients, loans disbursed, women participation and savings with banks. NABARD and SIDBI have been key architects in designing the development process of the microfinance sector. Microfinance has been successful in providing financial services to the marginalised section of the economy, developing the habit of savings, reducing financial deficits of the poor households, promoting financial inclusion, generating employment opportunities and enhancing income through innovative practices and by creating a direct link and developing trust with the stakeholders thus, ensuring their participation in the developmental process. However social development and welfare initiatives should be encouraged to make the development process sustainable.

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