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The scenario of Microfinance in India

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Introduction

\# Robinson (2001) defines microfinance as "small-scale financial services – primarily credit and savings – provided to people who farm, fish or herd" and adds that it "refers to all types of financial services provided to low-income households and enterprises."

\# "Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban areas for enabling them to raise their income levels and improve living standards".

--Taskforce on supportive policy and Regulatory Framework for Microfinance (1999)

Understanding Microfinance

- "Microfinance is the financial services for the poor and small borrowers in the rural areas and resource poor regions for their economic independence."

  -- Mohanty (1997)

- "Microfinance as a market based formal mechanism to mitigate the risks faced by poor people as against the informal group based mechanism like savings and credit associations".

  -- Tara (2001)

- "Microfinance as the entire range of financial services rendered to the poor and includes skill up gradation, entrepreneurial development that would enable them to overcome poverty".

  -- Puhazhendi and Satyasi (2002)

Micro Credit vs. Micro Finance

- **Microcredit** is the extension of very small loans (microloans) with little or no collateral to the unemployed, to poor entrepreneurs and to others living in poverty who are not considered bankable otherwise by the registered institutions.
- **Microfinance** "refers to all types of financial services including microcredit provided to low-income households and enterprises."

COMPARISON OF FORMAL AND SPECIAL INSTITUTIONS

Specialised m.F.I.s	Formal banking system
High institutional building cost	No additional building cost
Big amount of money to recruit, to train new staff	Excellent human capital already exist
No flexible credits cum saving policies	Flexible credit lines
Irregular inflow of funds- disturb regular delivery of credit service	Regular repayment from NABARD
Interest rates are high	Market rate of interest

FAILURE OF DIRECT CREDIT APPROACH

- Break down of loan repayment discipline
- Didn’t catered consumption needs
- In adverse situation production loan diverted
- Lack of awareness among beneficiaries
- Difficulty for bankers
  - High transaction cost for small savings and loans
  - Accounts scattered over a wide area
  - Mounting over dues due to defective loan policies
- Small savers and borrowers viewed banking as an institutional set up for elite.
- Visit to bank branches lead to loss of earning for that day

WHAT THE POOR HOUSEHOLDS IN RURAL AREA NEED?

- Opportunities to keep safe their occasional small surpluses in the form of thrift

- Access to consumption loans to meet emergent needs

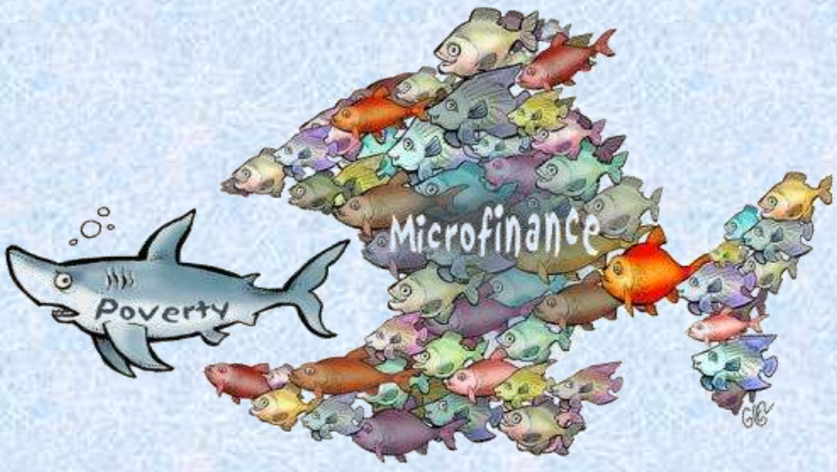
- Hassle free assess to financial services and products including loans for micro enterprises

EVOLUTION OF MICROFINANCE

- In 1992, NABARD started SHG-Bank Linkage Programme (SBLP) as a pilot against the backdrop of a huge banking structure unable to adequately address the credit needs of the poor.
- Encouraged by the positive success of the project RBI advised the bank to mainstream the SBLP.
- The programme acquired national priority from 1999 onwards with successive union budget pronouncements.
- In 1999, the GoI merged various credit programs together, refined them and launched a new programme called Swaranjayanti Gram Swarazagar Yojana (SGSY) to provide subsidized credit to the poor through the banking sector to generate self-employment.
- Since 2000, commercial banks including RRBs and few cooperative banks have been providing funds to MFIs for on-lending to poor clients.

Objectives

- To evaluate the flow of credit to agriculture sector (rural sector)
- To study the progress of microfinance in India
- To analyse the performance of microfinance across the states
- To assess the factors affecting the microfinance



Flow of credit to agriculture sector (rural sector):

- **There is a link between the access to financial services, growth and poverty alleviation.**

- **Inclusive financial systems are associated with faster growth and better income distribution.**

- **In India since the early national plans the role of finance in promoting equitable growth is emphasized.**

- **In order to address this issue the country has built a massive infrastructure :**
  - **NABARD**
  - **over 32,000 rural branches of schedule commercial banks**
  - **Regional Rural Banks (RRBs),**
  - **14000 cooperative bank branches,**
  - **98000 primary agricultural credit societies.**

MFIs & SHG-Bank linkage programme

- Multiple lending and overburdening of rural households.
- Not engaged in capacity building and empowerment of the groups to the desired extent.
- Disburse loans to the newly formed groups within 10–15 days of their formation, as a result, cohesiveness and a sense of purpose were not being built up in the groups formed by these MFIs.
- Banks, as principal financiers of MFIs, do not appear to be engaging them with regard to their lending policies with a view to ensuring better transparency and adherence to best practices.

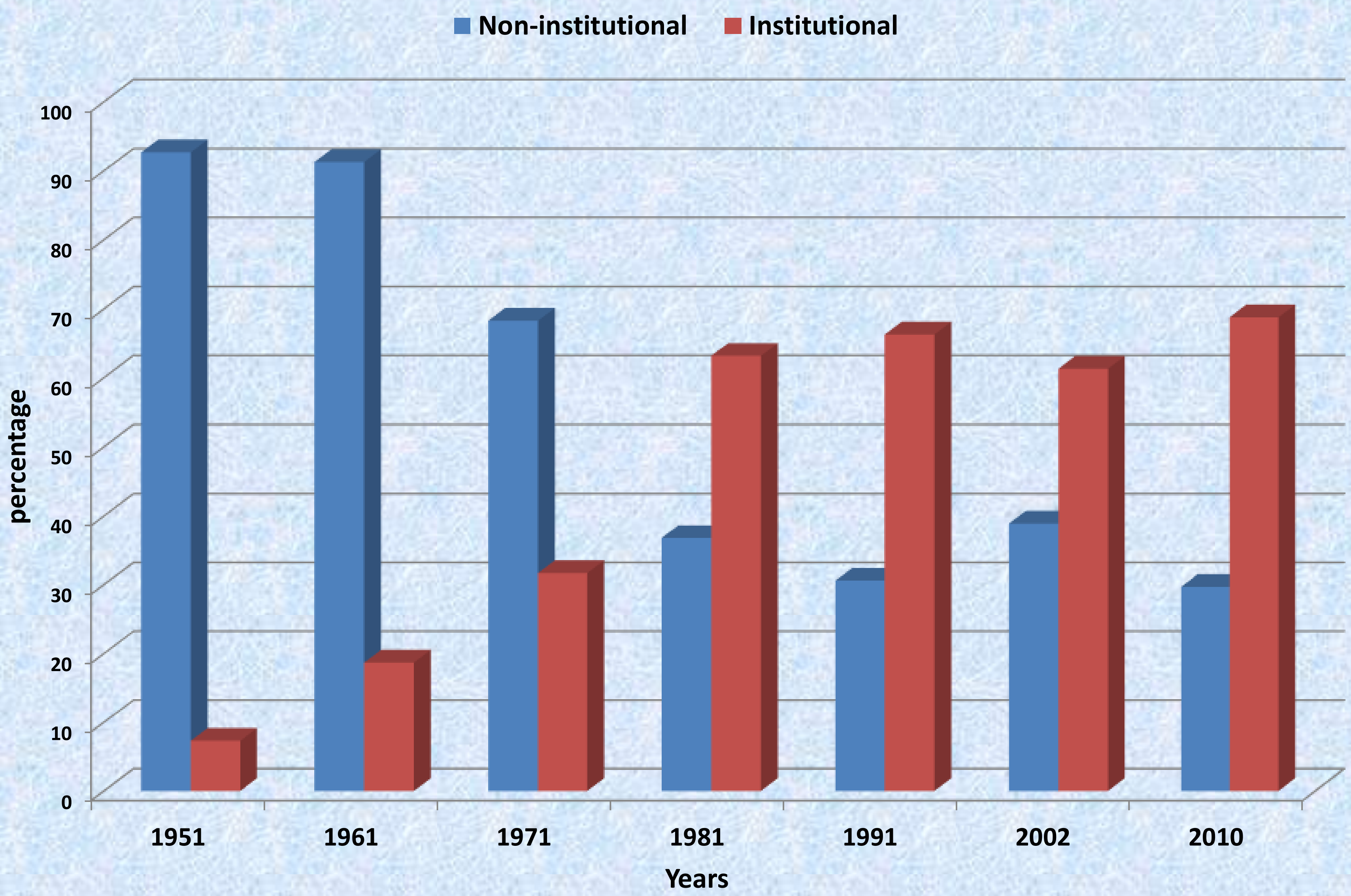
MFIs of India (Listed in World's top 50 MFIs in Forbes International Magazine)

- Bandhan (10th)
- Microcredit Foundation of India (ranked 13th)
- SaadhanaMicrofin Society (15th)
- Bangladesh-based Grameen Bank (Nobel Prize).
- GrameenKoota (19th)
- Sharada's Women's Association for Weaker Section (23rd)
- SKS Microfinance Private Ltd (44th)
- Asmitha Microfin Ltd (29th).

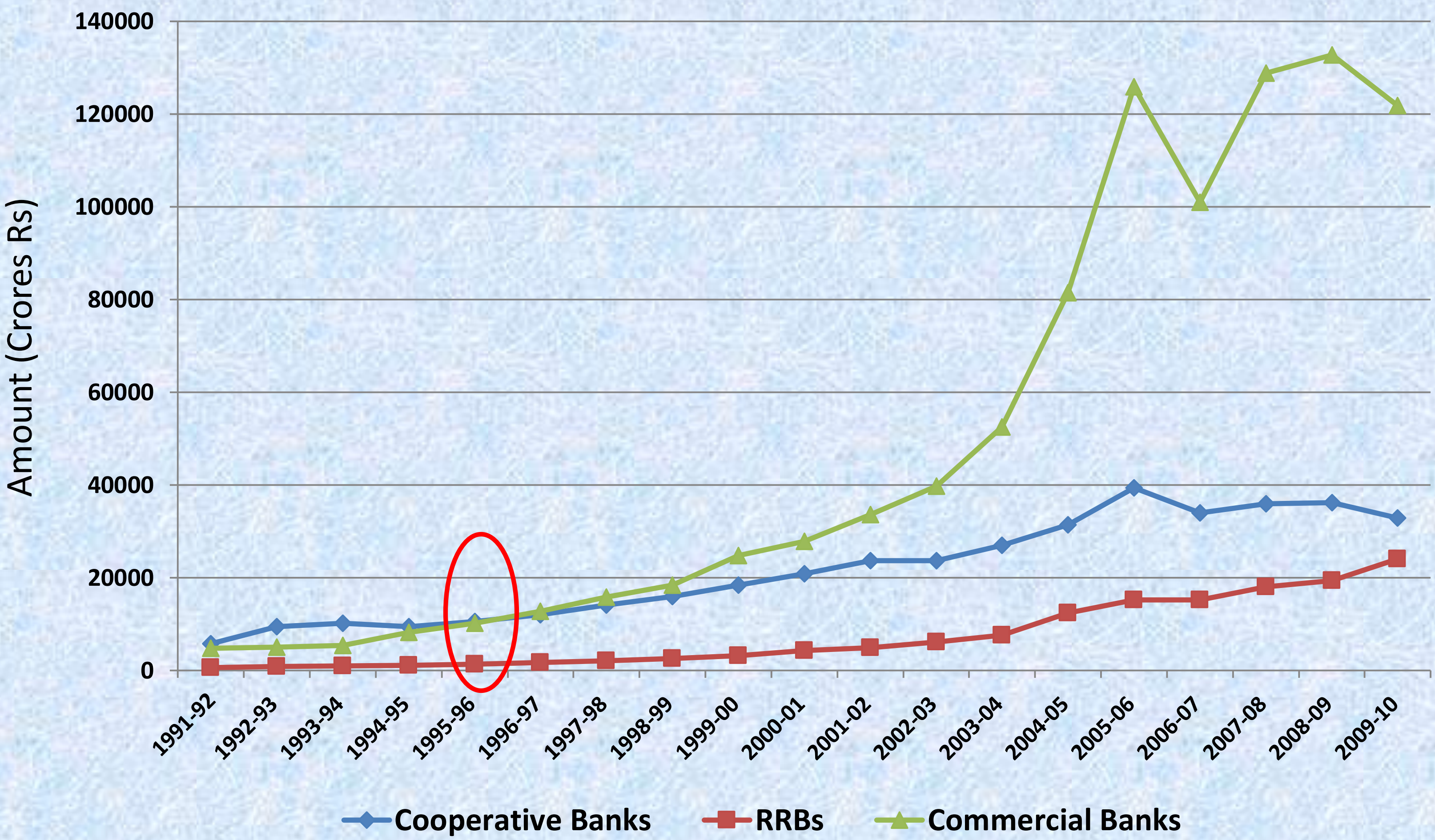
Structure of Agricultural credit in India

- Government of India & RBI
  - NABARD
    - Commercial Banks
    - Rural Cooperative Credit Institutions
      - Long term Cooperative Credit Institutions
        - State co-operative agricultural and rural development banks
          - Primary co-operative agricultural and rural development banks
      - Short term Credit Institutions
        - State co-operative banks
          - District central co-operative banks
            - Primary agricultural credit societies
    - Regional Rural Banks

Borrowing of cultivator households from different sources (% share)



Flow of credit to agriculture by different agencies over time



How inclusive is Indian banking today?

- Out of around one billion people in India, 26% are poor (National Statistical Sample Organization, 2000).

- Some 59% of rural households do not have a deposit account and 79% of rural households do not have access to credit from formal source.(RFAS 2003)

- Marginal, small and large farmers paradox

- This disparities is attributed to the “risk aversion” tendency of the bankers towards small and marginal farmers as against the large farmers, who are better placed in offering collaterals.

Continued….

- **At the bottom the poor need credit for small productive assets, working capital, housing, illness, and emergencies.**

- **Most of the Indian rural women and men are agricultural labourers, for them flow of income is sporadic, so they require credit for consumption during off season.**

- **The demand for credit here is not only large but heterogeneous as well.**

- **Till the 1990s the rural financial system in India was predominantly supply driven .**

Continued….

- Although govt insisted the commercial banks to lend credit to agriculture through priority sector lending “Formal banks have always been reluctant to serve the poor, especially the asset poor, who cannot offer any collateral”

- Banks are able to reach priority sector target by subscribing to other eligible instruments than direct lending.

- Credit required for consumption is always denied by formal banking sector, so the rural households divert the production loans for daily consumption needs.

- The micro-credit constitutes a very small percentage of the total lending of commercial banks i.e. less than one per cent. (Planning commission, 2007)

Continued….

The following elements are necessary for an inclusive financial system:

- **Flexible products**
- **Composite financial services**
- **Simplification of procedures to open a bank account, access credit etc.**
- **Better staffing policies and doorstep banking**

There are three kinds of costs incurred by formal financial institutions:

- **cost of funds**
- **operating costs**
- **cost of loan losses**

Progress and performance of microfinance

- The microfinance movement in the country started in the year 1992, having learnt from the efforts of Grameen Bank in Bangladesh and Bank Rakyat Indonesia (BRI), Indonesia.

- The micro credit programme which started with a modest pilot project of linking around 255 SHGs way back in 1992 has made rapid strides in India exhibiting considerable democratic functioning and group dynamism.

- The programme has now assumed the form of a micro finance movement in many parts of the country.

- Microfinance has become an attractive mechanism to reach financial services to the poor, reduce transaction costs, eliminate basic problems of incorrect client identification and mitigate repayment risks to a great extent

Continued….

- Microfinance sector has traversed a long journey from micro savings to micro credit then to micro enterprise and now entered the field of micro insurance, micro remittance and micro pension.

- The formal financial institutions in India have ventured into microfinance in a massive way by adopting the SHG-Bank Linkage Program model.

- An understanding of the specific reasons or external conditions that are conducive to the growth of microfinance in certain regions that are not there elsewhere is need of the hour. The growth of SHG credit has been uneven.

Continued….

- The Southern states are seen as SHG-developed states while Bihar and Madhya Pradesh are among those characterized as SHG-backward (Dasgupta, 2005).

- The factors that constrain the growth on the demand side of the micro-credit and microfinance has not been studied in detail (Nair, 2005). This mainly includes factors such as infrastructure (i.e., irrigation, roads, etc) that determine the credit absorption capacity of the households and regions.

- Microfinance Institutions has had a tremendous beneficial effect in bringing down the interest rates charged by the moneylenders from 2 to 30% per month to an uniform level of 3 to 5% per month. One reason why high interest rates prevail is because timely availability of credit is more important than cost of credit perse. (K.G.Karmakar)

Review

- Sharma and Wright (2010) says that commercialization of Indian microfinance has allowed a massive increase in outreach and expansion of credit to the poor in India, at rates of interest that are by world standards at least.

- Srinivasan R (2006) argues that too low interest rate may even tempt a member to borrow from the SHG, not for production or consumption within her household, but for on-lending in the informal market, possibly increasing the loan portfolio risk considerably.

- The high repayment rate was due to the dynamic incentive system built into the SHGs, i.e., the repayment rate in time, makes one eligible for enhanced loans in the subsequent period (Datta and Dadhich, 2001)

Continued….

- **Though loan repayment is a joint liability of the group but, in reality, individual liability is stressed upon. Maintaining group reputation leads to the application of tremendous peer pressure. (Ranjula B S, 2007)**

Moyoux (2001) For repayment, reliance on peer pressure rather than individual incentives and penalties may create disincentive and corruption within groups.

- **NABARD provides subsidised refinance support to banks, however the demand for refinance support to banks has fallen, as SHG lending is more profitable with lower default rates (Basu and Srivastava, 2005)**

Joint Liability Groups (JLGs)

Joint Liability Groups was launched in 2004-05 on the lines of SHG-Bank linkage programme.

A Joint Liability Group (JLG) is an informal group comprising preferably of 4 to 10 individuals coming together for the purposes of availing bank loan either singly or through the group mechanism against mutual guarantee.

OBJECTIVES

- To augment flow of credit to farmers, especially small, marginal, tenant farmers, oral lessees, sharecroppers /individuals taking up farm activities.
- To extend **collateral free loans** through JLG mechanism.
- To provide food security to vulnerable sections.

Who can form JLGs?

Business Facilitators, NGOs, Farmers' Cubs, Farmers Associations, Panchayat Raj Institutions (PRIs), Krishi Vikas Kendras (KVKs), State Agriculture Universities (SAUs), Agriculture Technology Management Agency (ATMA), Bank branches, PACS, Other Co-operatives, Government Departments, Individuals, Input dealers, MFIs / MFOs etc.

Saving by JLG

All the JLG members may be encouraged to open an individual "No Frills" account.

In case JLG chooses to undertake savings along with credit operations - savings account

The quantum of loan to be given to the group should be related to the credit needs and not to the quantum of savings

JLG Models

Model A – Financing Individuals in the Group

Model B – Financing the JLG as a Group

Rate of Interest

- RoI applicable to agriculture advances are charged.
- Short term loans sanctioned to a JLG, the per member cap of Rs. 3.00 Lakh be considered while determining RoI under interest subvention scheme and not the aggregate amount sanctioned to a JLG.

Loan Limit and margin

Loan limit	Margins (in %)
Up to Rs.1.00 lac	Nil
Above Rs.1.00 lac	10-15%

Micro Units Development Refinance Agency,2015

- Mudra stand for micro units development refinance agency.
- Mudra means currency in Hindi.
- Set up through a statutory enactment
- Responsible for developing and refinancing activities to micro units.

Offering of MUDRA

- Shishu : covering loans up to 50,000
- Kishor : covering loans above 50,000 and up to 5 lakh
- Tarun : covering loans above 5 lakh and 10 lakh

Major objectives of MUDRA

- Laying down policy guideline for micro enterprise financing business
- Registration of MFI entities
- Supervision of MFI entities
- Accreditation / rating of MFI entities
- Laying down responsible financing practices to ward off over indebtedness and ensure proper client protection principle and method of recovery
- Development of standardised set of covenants governing last mile lending to micro enterprise
- Promoting right technology solution for the last mile
- Formulating and running a credit guarantee scheme for providing guarantee to loans/ portfolios which are being extended to micro enterprise
- Supporting development and promotion activities in the sector
- Creating a good micro business under the scheme of Pradhan Mantri MUDRA Yojana

SELF HELP GROUPS-CONCEPT

- A group comprising 10 to 20 member, from homogeneous class based on proximity
- Members make voluntary thrift regularly-a small amount that they can afford
- Use the pooled saving to make loans to needy members which bear a small interest rate
- Majority of SHGs in India are women groups

ADVANTAGES OF FINANCING SHGS

- For banks
  - The SHG saving is hard earned money of members.
  - Being high cautious in the use of saving SHG members acquire financial discipline, account keeping ability and credit history
  - Saving is the precondition for credit in SHGs
  - High group pressure on members to repay the loan timely
- For SHG members
  - Reducing the dependence on money lenders, who charge very high interest rate
  - Access to formal financing system

SHG-BANK LINKAGE MODELS

- The Indian micro finance scene is dominated by SHGs and their linkage to banks
- Three prominent models in SHG-Bank linkage

Model	Type	% of linkage
I	Banks form and finance SHGs	16
II	SHGs formed by NGOs and financed by banks	75
III	NGOs and other agencies, as financing intermediaries between banks and SHGs	9

Self Help Group – Bank Linkage Model

- Strategy for delivering financial services to the poor in a sustainable manner.
- Initiated by NABARD in 1992

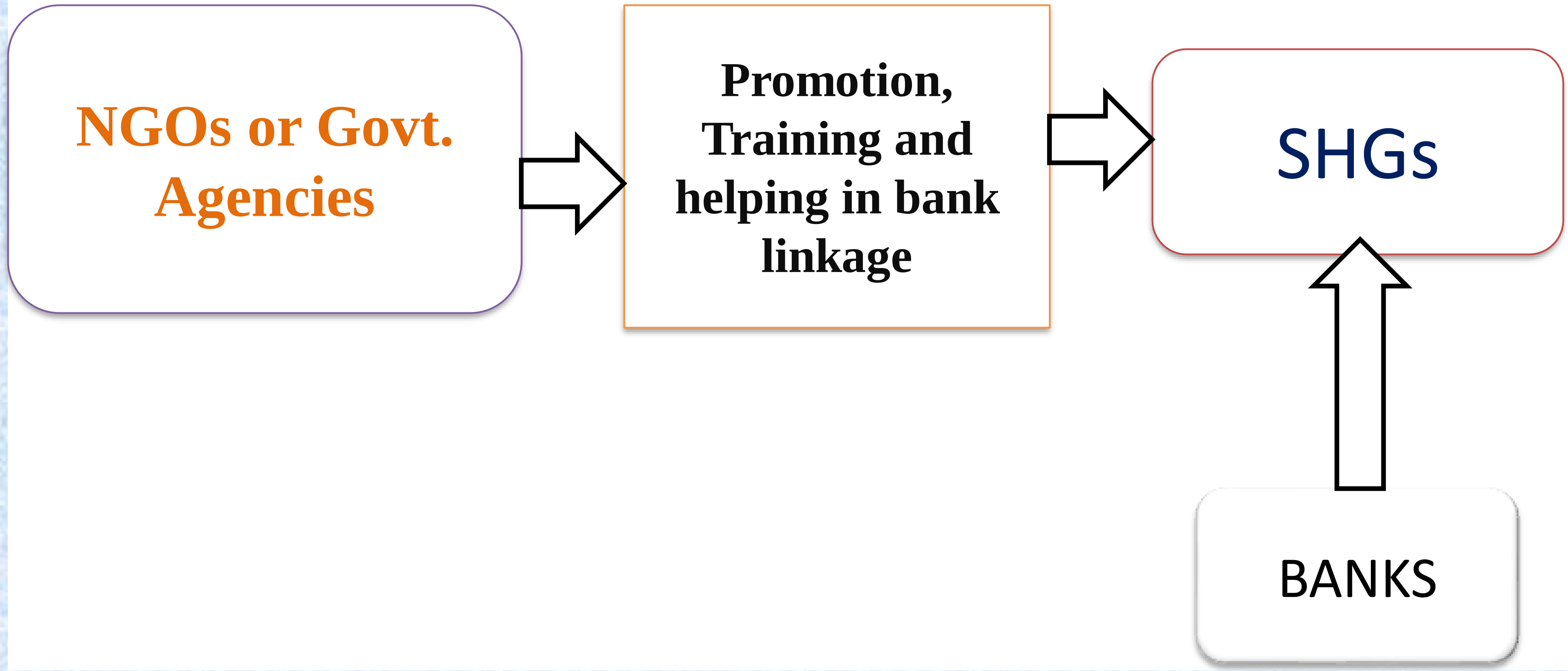
Impact:

- Creating awareness
- Reduced incidence of poverty
- Empowerment of women
- Reduced dependency on non-institutional sources

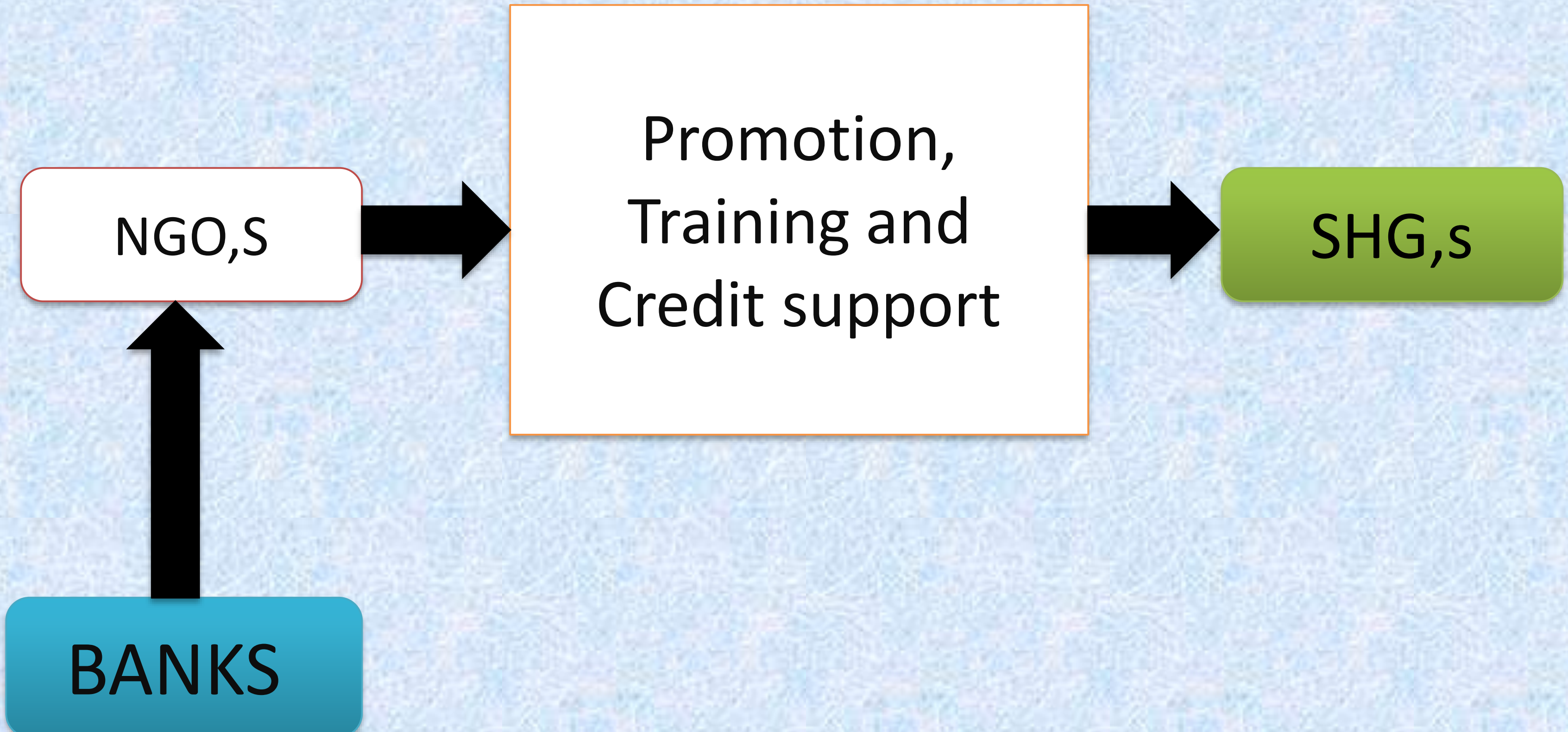
MODELS

Model-I

Model-II


NGOs or Govt. Agencies
Promotion, Training and helping in bank linkage
SHGs
BANKS

Model-III



SUPPORT FROM NABARD

I. Financial
   i. Refinance to banks
   ii. Direct loan funds to NGOs, m .F.Is and SHG federations
   iii. Credit and financial service fund
   iv. Micro finance development funds
II. Capacity building
   i. Training programme for SHG members, bankers, NGO staff, Government officials
   ii. Exposure visits to banks and institutions
III. Group building
   i. Grant assistance to NGOs for promotion of linkage and RRBs to act as self help promoting institutions

SHG AS RETAIL FINANCING SYSTEM IN VILLAGES

I. Bank loans to SHGs

- ‘Bankability’ recognition’ to SHG after six months of normal functioning
- Loan facility sanctioned at market rate of interest
- Loan to saving ratio 1:1 or 1:2, gradually increased to 4:1
- Substitution of collateral by group liability and volume of saving
- Usually short or medium term loans

SHG AS RETAIL FINANCING SYSTEM IN VILLAGES- *Continued*

II. SHG loans to members

- Savings and bank loans pooled together
- Loans to needy members from pooled savings
- Decision about the beneficiary by the group
- No monitoring by bank staff

SUCCESS FACTORS IN SHG BANKING

- Voluntary and active participation of members
- ‘Saving first’ concept
- ‘Self help’ and autonomy
- Flexibility and spontaneity
- Low additional cost and marginal loan losses for banks
- Informal insurance system in village-SHG system manage risk and income gap effectively
- Stimulate self reliance
- Mobilization of underused capacities of target groups
- Encouragement and flexible fund support from NABARD

ACHIEVEMENT OF SHGs

- Frequent transactions for saving and borrowing at irregular intervals
- Tunes the allocation of funds with the needs of group members
- Flexible credit line from the banking systems
- Deposit facilities both at group level and bank level

ECONOMIC IMPACT ON POOR HOUSE HOLDS

- Enable increased propensity to save
- Enhanced net incremental income
- Smoothen income inequalities
- Reduction of indebtness with money lenders
- Additional employment generation
- Facilitate empowerment of women

CONSTRAINTS

- Drop out of SHG members due uneven distribution of benefits
- Target orientation of formal banks- members of groups may not be from lower income groups
- Some SHGs consider saving mobilization only as an instrument for ‘bankability’
- For SHG members return on investment is still small
- Lack of special saving schemes
  - ✓ To cover the risk of default members
  - ✓ To accept individual saving deposit other than collective saving

FUTURE STRATEGIES

- Development of instruments for proper rating of SHGs
- Development of organizational tools and problem solving mechanism by participating banks, for
  - Effective facilitation of SHG sustainability
  - Better management and supervision of SHGs
- Establishment of SHG federation
- Support to upcoming private micro finance institutions in non-government sections by NABARD

FUTURE STRATEGIES-*Continued*

- NABARD support for special institutional development grants like –start up capital, scaling up capital, additional equity support etc.

- Scope for inclusion of new saving products and insurance products

- Special saving account to cover
  - Risk of hospitalisation
  - Loss of house
  - Loss and damage of livestock
  - Theft

- Establishment of loan reserve fund

SWOT Analysis of micro-finance

STRENGTH:

Helped in reducing the poverty

Huge networking available

WEAKNESS:

Not properly regulated

High number of people access to informal sources

Concentrating on few people only

OPPRTUNITY:

Huge demand and supply gap
Employment Opportunity

Huge Untapped Market

Opportunity for Pvt. Banks

THREAT:

High Competition

Neophyte Industry

Over involvement of Govt


Thank you