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An Overview of Indian Microfinance–Its Accomplishment, Challenges and SWOT Analysis

Meena Rajesh

G.H. Raisoni Institute of Management & Research Nagpur
E-mail: meena.rajesh@raisoni.net

Abstract: *Microfinance in India is gaining a momentum to accelerate economic growth and reduce poverty in India. This paper set out the current state of Indian microfinance with a brief history and its accomplishments and challenges faced in India. The term microfinance refers to small savings, credit and insurance services extended to socially and economically disadvantaged segments of society in order to enable them to raise their income levels and also improve their standard of living. The Government of India and NABARD has been instrumental in bringing new policy changes towards the development of microfinance institutions in India. In spite of the impressive growing numbers MFI's in India, there is lot of scope for poverty alleviation. It is hard to measure and quantify the effects of Indian microcredit experience on poverty situation in India. However the microfinance through Self Help Group (SHG) has effectively graduated from the experiment stage to widely accepted development financing format in India. The major challenge lies in the fact that Inclusive growth requires not only physical, natural and human capital, but also social capital. Also further we need to a have a reality check of 'what is really happening', uniquely exploring both social and financial performance in the MFI sector in general and Self-Help Group (SHG) movement in particular.*

Keywords: *Microfinance, SHG*

1. INTRODUCTION

In ancient origins in India there existed a concept of Microcredit, small loans to poor. The traders and moneylenders have provided credit to poor rural people at high rate of interest, which led to exploitation of poor and resulted in undesirable and illegal practices like bounded labour or acquisition of properties. But in today's modern world what we mean by microfinance does not include such negative and exploitative practices but rather helps the poor to get loans and other financial benefits at a reasonable rate.

India that has the largest population of poor in the world has been experimenting with microfinance as tool for poverty alleviation. The main objective behind microfinance is that the urban and rural poor should be able to get access to financial services even in absence of any collateral securities. Microfinance started off with microcredit- small loans to poor to help them in uplifting their standard of living through engaging them in productive and self-sustaining activities. The outstanding success of Grameen Bank in the neighboring country Bangladesh had inspired many financial institutions in India to adopt microfinance.

In India microfinance movement have received overwhelming response in western and southern region of the country when compared to other parts. The Small Industries Development Bank of India (SIDBI) and National Bank of Agriculture and Rural Development (NABARD) are leading institutions in India promoting microfinance.

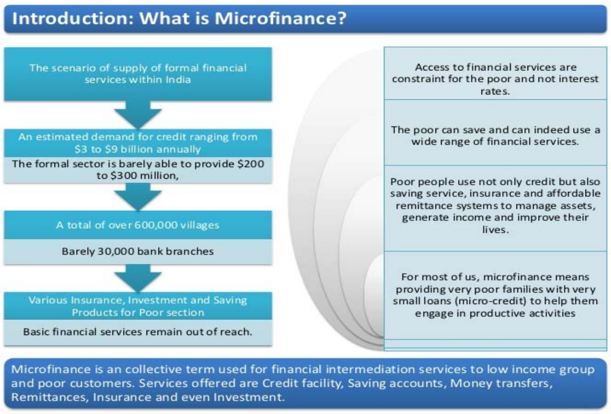
Over the years the there had been an unmatched growth in rural banking sector where the priority of these banks were lending to poor. India has been growing unparallel in networks of rural banks in the world. There are 56 RRB and 525 districts with a network of 14,494 branches. In spite of such a wide coverage these banks had a minimum impact on microfinance or lending to poor.

The Regional rural banks came into existence as the cooperative and other commercial banks in rural India were being dominated by some rich wealthy rural people. The first two decades of RRB's existence was featured with accumulated losses of Rs.3000 Crs. But due to reforms made in mid 90's on the recommendation of the Narsimhan Committee report, the RRB's started functioning in a better way thereby easing the interest rates and investing in the money market. Though the financial situation is better now as 80% of RRB are doing well but their impact has not been much on poor people of rural areas. Thus there has been always a struggle between balancing the objectives of outreach and financial performance.

In case of commercial banks the lending portfolio has slowly shifted from urban to rural areas as the overall low cost segments (loans to poor) performed better than the other financial products. Thus Microfinance provides a balance between the rural outreach and cost of lending.

2. REVIEW OF LITERATURE THEORY AND CONCEPT

Microfinance is the provision of financial services to low-income clients or solidarity lending groups including consumers and the self-employed, who traditionally lack access to banking and related services." Micro finance serves as an umbrella term that describes the provision of banking services by poverty focused financial institutions (micro finance institutions) to poor parts of the population that are not being served by mainstream financial services providers.



Micro finance: Micro finance includes wide range of facilities of services to poor such as savings microcredit and the insurance (Chakravarty & Shahriar, 2010). Microfinance institution provides the small loan to poor people who are disqualified for the formal loan (Morduch, 1999). According to Conroy (2002),

3. MICROFINANCE & MICRO CREDIT:

Micro finance is the wide range of provision of financial services included services of payment, accepting deposits, lending loans transfer of money and insurance to low income and poor people. Whereas the two terms such as micro enterprises and micro credit financing include the value of borrowing as well as savings. Microfinance is the whole field whereas the other two terms are specifically related to provision of credit (Maria, 2004). Micro credit: Micro credit can also be called micro lending it can be defined as "A very small loan given to poor people for helping them to be self-employed". It is given to poor ones for increasing the living standard of loan taker by investing it in income giving activities (Fernando, 2006). Microcredits are: These loans are too small, no collateral required, mostly have weekly payments, short term such that less than one year loan, it is mostly for the women and poor people who are not eligible for borrowing the formal loan.

4. HISTORY

The history of microfinance in the world some of the most important factors for economic growth and development are the financial and human resources. All of the potential human capital even poor people could have serious role in the economic growth if they have the initial required capital to create job and produce goods and services. So the idea of financing the poor people is shaped for decades. In this part of the article, the history of microfinance is presented by introducing some of the important Microfinance

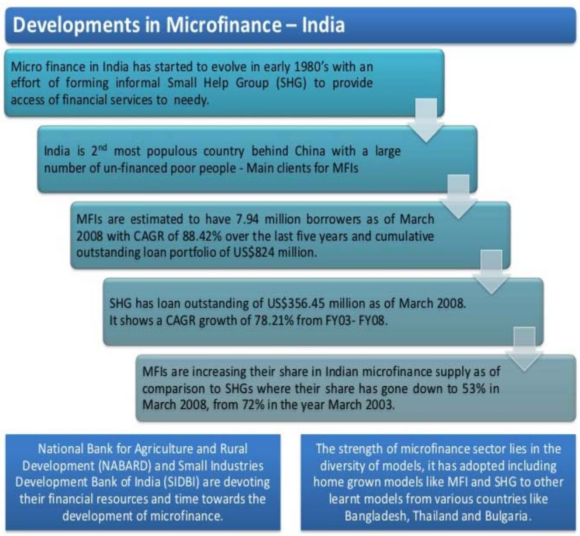
Institutions one of the earlier and longer-lived micro credit organizations providing small loans to rural poor with no collateral was the Irish Loan Fund system, initiated in the early 1700s by the author and nationalist Jonathan Swift. Swift's idea began slowly but by the 1840s had become a widespread institution of about 300 funds all over Ireland. Their principal purpose was making small loans with interest for short periods. At their peak they were making loans to 20% of all Irish households annually.

In the 1800s, various types of larger and more formal savings and credit institutions began to emerge in Europe, organized primarily among the rural and urban poor. These institutions were known as People's Banks, Credit Unions, and Savings and Credit Co-operatives. The concept of the credit union was developed by Friedrich Wilhelm Raiffeisen and his supporters. Their altruistic action was motivated by concern to assist the rural population to break out of their dependence on moneylenders and to improve their welfare. From 1870, the unions expanded rapidly over a large sector of the Rhine Province and other regions of the German States. The cooperative movement quickly spread to other countries in Europe and North America, and eventually, supported by the cooperative movement in developed countries and donors, also to developing countries.

In Indonesia, the Indonesian People's Credit Banks (BPR) or the Bank Perkreditan Rakyat opened in 1895. The BPR became the largest microfinance system in Indonesia with close to 9,000 units. In the early 1900s, various adaptations of these models began to appear in parts of rural Latin America. While the goal of such rural finance interventions was usually defined in terms of modernizing the agricultural sector, they usually had two specific objectives: increased Commercialization of the rural sector, by mobilizing "idle" savings and increasing investment through credit, and reducing oppressive feudal relations that were enforced through indebtedness.

Starting in the 1970s, experimental programs in Bangladesh, Brazil, and a few other countries extended tiny loans to groups of poor women to invest in micro-businesses. This type of microenterprise credit was based on solidarity group lending in which every member of a group guaranteed the repayment of all members. In 1971, Opportunity International, founded by Whittaker and David Bussau, lend to Micro Entrepreneurs in Indonesia and Columbia. In 1979 they expand across Southeast Asia and South America. In 1972 the Self Employed Women's Association (SEWA) was registered as a trade union in Gujarat (India), with the main objective of "strengthening its members' bargaining power to improve income, employment and access to social security." In 1973, to address their lack of access to financial services, the members of SEWA decided to found "a bank of their own". Four thousand women contributed share capital to establish the Mahila SEWA Co-operative Bank. Since then it has been providing banking services to poor, illiterate, Self-employed women and has become a viable financial venture with today around 30,000 active clients Prof. Yunus creates Grameen Bank in 1983. To date, Grameen has lent more than $6 billion (to 7.4 million Bangladeshis). Its methods have become the basis for modern microfinance that includes group lending, women-focused, and good repayment rates

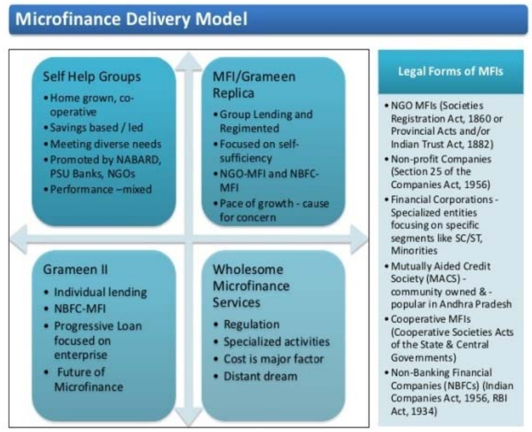
5. MICROFINANCE IN INDIA



Microfinance sector has grown rapidly over the past few decades. Nobel laureate Muhammad Yunus is credited with laying the foundation of the modern MFIs with establishment of grammen bank, Bangladesh in 1976.today it has evolved into a vibrant industry exhibiting a variety of business models. Microfinance banking financial companies (NBFCs).commercial banks, regional rural banks (RRBs), cooperative societies and other large lenders has played an important role in providing refinance facility to MFIs. Banks have also leveraged the self help group (SHGs) channel to provide direct credit to group borrowers.

With financial inclusion emerging as a major policy objective in the country, microfinance has occupied centre stage as promising conduit for extending financial services to unbanked sections of population the same time, practice followed by certain lenders have subjected the sector to greater scrutiny and need for stricter regulation.

Micro finance is a novel approach to 'banking with the poor' and this system attempts to combine lower transaction costs and high degree of repayments. According to recent survey (Parida and Bandhu: 2012) More than One billion poor people have no access to basic financial facilities, which are essential for them to manage their precarious lives. (Uttam Paul, 2014)



According to Kofi Annan (former Secretary General of the UNO) states that "Microcredit is a critica anti-poverty tool a wise investment in human capital. When the poorest, especially women, receive credit, they become economic actors with power. Power to improve not only their own lives but, in a widening circle of impact, the lives of their families, their communities, and their nations." Uttam Paul, 2014.

Types of Micro financial Institutions in India

Olive	Types of MFI's	Number	Legal Registration
Profit Motive	Non Banking Financial Companies(NBFC's)	45	Indian companies Act ,1956,RBI Act 1934
Non Profit Motive	NGOs	400-500	Society Registration Act ,1860 Indian Trust Act 1882
	Non Profit Companies	20	Section 25 of Indian Companies Act,1956
Mutual Benefits MFI's	Mutual Benefit MFI-Mutually Aided Cooperative Societies (MACS)	200-250	Mutually Aided Co-operative Societies ,Act Enacted by State Governments

Sources: Adapted from the Report of the Task Force on Supportive Policy and Regulatory Framework for Microfinance (NABARD 2012)

6. NEED OF THE STUDY

There is a growing need of microfinance because it act as a source of finance for poverty alleviation, procurement of agricultural and farms input. As India is an agricultural economy microfinance act as tool to empower the rural and poor people to make their livelihood**.** So the researchers are interested to find out the scopes of microfinance in rural India and also the challenges and opportunities available to these institutions in India. This research paper is highlighting the strength, weakness, opportunities and threats of microfinance institutions.

7. METHODOLOGY

The basic foundation of the study is based on the secondary sources of information like research papers, conference papers, working papers, speeches, web documents, books etc. Primary sources of information are limited to personal observation and face-to-face interviews. Micro credit models, its replication and commercialization issues come from the secondary sources.

MFI's Accomplishments & Challenges:

There had been some major initiatives taken by NABARD to support Microfinance Institutions.
Capital support: Microfinance Development Fund was set up with NABARD by government of India in 2000-01 with the initial corpus of Rs.100 crs which was increased to Rs.400 crs in 2010-11.
Revolving fund assistance to MFI's was given on selective basis for them to lend to SHG or individuals.
Ratings of MFI are by credit rating agencies like CRISIL, MCRIL, ICRA, and CARE for their performance.

Micro Finance Institutions (Development Regulation) Bill, 2011

A Bill to provide access to financial services for the rural and urban poor and certain disadvantaged sections of the people by promoting the growth and development of micro finance institutions as extended arms of the banks and financial institutions and for the regulation of micro finance institutions and for matters connected therewith and incidental thereto.

The following things were part of the bill:

- **Constitution of Micro Finance Development Council**– on formulation of policies, schemes and other measures required in the interest of orderly growth and development of the micro finance sector and micro finance institutions, to promote financial inclusion.
- **State advisory councils:** for Micro Finance at the State level and considering the extent of micro finance activities in the States
- **Registration of Microfinance Institutions:** MFIs shall not commence or carry on the activity of providing micro finance services without obtaining a certificate of registration from the Reserve Bank under this Act.
- **Reserve, Accounts, Audit & Returns:** Create a reserve fund & transfer there in a sum, representing such percentage, as may be specified by the RBI, of its net profit or surplus realized by providing MF services every year.
- **Function and powers of Reserve Bank**: promote and ensure orderly growth for purpose of financial inclusion.
- **Redressal Mechanism**: appoint Micro Finance Ombudsmen for purpose of redressal of grievances between client and MFIs.

8. MALEGAM COMMITTEE RECOMMENDATIONS:

- All bank loans to MFIs, including non-banking financial companies (NBFCs) working as MFIs would be treated as *priority sector* lending (conditions to qualifying asset criterion).
- Loan must be to rural household with annual income of not more than INR 60,000. For urban or semi-urban borrower, household income must be INR 120,000 or less.
- Loan amount cannot exceed INR 35,000 in first cycle and INR 50,000 in subsequent cycles.
- A household's total indebtedness at any given time should not exceed INR 50,000
- Loan term should not be less than 24 months for amounts more than INR 15,000 without prepayment penalty.
- Loans to be extended without collateral
- Aggregate amount of loan for income generating purposes must be at least 75% of total advances.
- Loans must be repayable by weekly, fortnightly or monthly insallments, the choice of which will vest with the borrower.
- To qualify as priority sector loans, banks must ensure a margin cap of 12% and an interest rate cap of 26%
- MFI loans can be extended to individuals outside of self-help groups (SHG) or joint liability group (JLG)
- Bank loans to other NBFCs will not be treated as priority sector leading effective April 1, 2011.

9. CHALLENGES FACED BY MFI'S

- Finding adequate levels of equity for the new entities to leverage loan funds
- Ability to access loan funds at reasonably low rates of interest.
- Ability to attract and retain professional and committed human resources.
- Design of apt MIS including user friendly software for tracking accounts and operations.
- Appropriate loan products for different segments
- The loans given to poor customers are invested in such things as tools, inventory and livestock where returns are low.
- The poor lack skills, education and the ability to create productive assets for steady income flows.
- Over-indebted clients
- In 2010, in the wake of a spate of suicides by borrowers, allegedly due to the coercive recovery practices employed by MFI agents, came the AP MFI Act, which mandates prior approval of every loan application by the state government authorities.

10. SWOT ANALYSIS:

Strength of Microfinance Institutions:

Alleviation of Poverty:

Over the last few years, Microfinance institutions have been successful in effective poverty alleviation through micro credit. The major motive of micro finance is to provide loans to the individuals below poverty line and who cannot access to commercial banks. MFI's provide small loans to poor people there by reducing the poverty. Self Employed women's Association (SEWA) in Gujarat are pioneers in this effort. In 1990's many NGO's made their entry into this segment. These NGO's had previously performed various developmental roles for poor people and now added micro credit to their service list.

Self Help Groups;

Self Help Groups among poor mostly women is growing phenomenon in rural India. The major advantage of this SHG is their joint liability and continuous peer pressure of member borrowers. In association with MFI's they try to reduce the transaction and monitoring cost.

Government involvement:

The government involvement in microfinance sector is blessing in disguise. There had been a big problem about the politicizing of the subsidy allotment amongst the SHG. The government subsidies are easily approachable to the panchayat members. These age old problems of government initiatives in poverty reduction can harm the movement by eroding the fundamental precepts of self help and empowerment of the poor.

11. WEAKNESS OF MICROFINANCE INSTITUTIONS:

- **Availability of less risky and more rewarding customers:** MFI's are funding hawkers and traders branded as poor in urban and semi urban and even in villages as their paying capacity is good. The farmers are avoided due to seasonal and unpredictable income sources.
- **Resistant to loan Farmers:**
  Farming is not yet become viable due to dependence on monsoon, inadequate irrigation facilities and lack of modernizing farming.
- **Wrong MFI assessment tools**:
  MFI's are still assessed on the basis of their coverage, profitability and high level of repayment index. They should be assessed on success in achieving their primary goals poverty alleviations and inclusive growth.
- High Transaction and service cost:
  As the average microfinance loan size is small the transaction cost on a percentage basis for a micro finance loan is higher. The operational cost is also too high as the loan origination and monitoring is done at the client doorstep with no deployment of technology.

Opportunities:

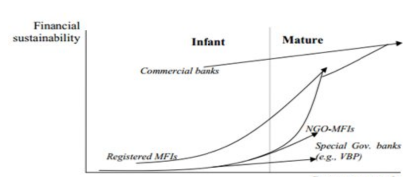
- Currently global microfinance sector is estimated loan portfolio of US $ 25 billions.
- In next 4 years the loan size of Indian market is expected to grow to a size of about Rs.250 billion from current market size of Rs.27 billion.
- There is a greater degree of capital market involvement.
- The attitude of Government of India and RBI is favorable towards MFI's
- Innovation in diversifying lender base, consolidating internal control system and strengthen policies on human resources, and disclosure of organizational process.
- There is growing migration and urbanization, which leads to higher average loan size and greater use of technology such as smart cards and point of sale devices with wireless connectivity. This would result in increasing urban microfinance.

Threats

- **Literacy & Skill levels of Clientele:**
- Low levels of literacy, relatively undiversified economies and high dependence on agriculture.
- **Irregular flow of income due to seasonality**: Due to seasonality of agricultural activities and unique requirement of financing such activities the repayment of loans can take place only after production.
- **Lack of Tangible proof for Assessment of Income:** Due to absence of land deed , no records like IT returns ,irregular flow of income due to seasonality constitutes lack of tangible income proof.
- **Need for Information sharing & Better Technology:**
- Due to lack of information about credit worthiness of potential clients there is adverse selection and over-indebtedness of clients, which is hazardous to microfinance institutions**.**

12. CONCLUSION

Microfinance is considered an important tool for poverty alleviation and empowerment of rural women. Microfinance program is not only helping in financial inclusion but also promotes banking habits, saving behavior and better financial utilization among poor.



The microfinance sector in India is on a growth. But the biggest challenges lie in development of investment potential and improvement of skills of poor borrowers. The potential for growing micro finance institutions in India is very high. Major cross-section can have benefit if this sector will grow in its fastest pace. As Micro finance becomes more widely accepted and moves into main stream, the supply of services to poor may also increase, improving the efficiency and outreach while lowering the costs. The purpose of this study was to understand microfinance in India and there is a huge potential to grow in future which in turn would improve the standard of living and happiness of poor people.

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