

# Journey of Microfinance in India

Rakesh Kumar\*

Research Scholar, Singhanian University, Pachari Bari, Rajasthan

**Abstract – The concept of micro credit is not new. It existed in every society in one form or other. Many informal credit groups have been operating in many countries for several years like the *susus* in Nigeria and Ghana, *chit funds* and *Rotating Savings and Credit Associations (ROSCAs)* in India, *tontines* in West Africa, *pasanaku* in Bolivia, *hui* in China etc. It is believed that initially, the informal financial institutions emerged in Nigeria dating back in the fifteenth century.**

-----X-----

## INTRODUCTION

Such type of institutions started establishing in Europe during the eighteenth century when in 1720 the first loan fund targeting poor people was founded in Ireland (Seibel, 2005).

In 1847, some credit co-operatives were created in Germany which served 1.4 million people by 1910. In 1880s the British controlled government of Madras in South India tried to use the German experiment to address poverty in India. This effort resulted in membership of more than nine million poor to credit co-operatives by 1946. During the same time the Dutch colonial administrators constructed a co-operative rural banking system in Indonesia which eventually became Bank Rakyat Indonesia (BRI), now one of the largest Microfinance Institutions (MFIs) of the world.

In the 1970s, a paradigm shift started to take place. Bank Dagan Bali (BDB), established in Indonesia in 1970, was the earliest bank to institute commercial microfinance.

In 1976, Muhammad Yunus, a professor of Economics at Chittagong University, Bangladesh initiated an experimental research project of providing credit to the rural poor. He gave a small loan of 856 Taka (\$27) from his pocket to 42 poor bamboo weavers and found that small loans radically changed the lives of these people and they were able to pay back the loans with interest. The success of this idea led Yunus to establish Grameen Bank in 1983 in Bangladesh. This programme showed rapid growth during the 1980s and 1990s. It is now adopted worldwide in the countries of different continents.

## NEED FOR MICRO FINANCE IN INDIA

According to latest research done by World Bank, India is home to almost one third of the world's poor

(surviving on an equivalent of one dollar a day). Though many central government and state government poverty alleviation programs are currently active in India, microfinance plays a major contributor to financial inclusion. In the past few decades, it has helped out remarkably in eradicating poverty. Reports show that people who have taken microfinance have been able to increase their income and hence the standard of living. About half of the Indian population still does not have a savings bank account and they are deprived of all banking services. Poor also need financial services to fulfill their needs like consumption, building of assets and protection against risk.

Since 1950s, various governments in India have experimented with a large number of grant and subsidy based poverty alleviation programmes. Studies show that these mandatory and dedicated subsidized financial programmes, implemented through banking institutions have not been fully successful in meeting their social and economic objectives:

The common reasons of failure of these programs are:

These programs were often not sustainable.

Led to misuse of both credit and subsidy.

Were treated as best poverty alleviation interventions.

According to a 1995 World Bank estimate, in most developing countries the formal financial system reaches only the top 25% of the economically active population- the bottom 75% have no access to financial services apart from money lenders.

In India too the formal financial institutions have not been able to reach the poor households, and particularly women, in the unorganized sector.

All this gave rise to the concept of micro-credit for the poorest segment. With the support of NGOs an informal sector comprising small Self Help Groups (SHGs) started mobilizing savings of their members and lending these resources among the members on a micro scale.

Success stories in neighbouring countries, like Grameen Bank in Bangladesh, Bank Rakyat in Indonesia, Commercial and Industrial Bank in Philippines, etc., gave further boost to the concept of microfinance in India in 1980s.

The Global Summit on Micro Finance held in Washington in Feb, 1997 set a global target of covering 100 million poor families with credit by 2005- it was expected that 25 -30 million of these could be in India alone. The planning commission estimate of 1993-94 says 36% of the population or 320 million people live below poverty line. Assuming that only 30% of the country's poor women are ready to adopt micro-finance as a method of poverty alleviation, it is estimated that all agencies in India engaged in the provision of micro-finance services, would have together covered barely 1 million poor people by close of 1998-99.

## DEVELOPMENT OF MICROFINANCE IN INDIA

In India, the first initiative to introduce microfinance was the establishment of self-employed women's associations (SEWA) in Gujarat. SEWA was registered as a trade union of self employed women workers of the unorganized sector in 1972. This trade union established their bank known as SEWA BANK in 1974. To establish this bank four thousand union members contributed rupees 10 each as share capital. Since then this bank is registered as a co-operative bank and has been providing banking services to poor women and has also become a viable financial venture.

The first major effort to reach these rural poor was made by NABARD in 1986-87 when it funded an action research project on "Saving and credit management of self-help groups" of Mysore resettlement and development authority (MYRADA). In 1988-89 NABARD undertook a survey of 93 NGOs spread over eleven States in India to study the functioning of SHG. In 1991-92 NABARD launched a pilot project of linking 500 SHGs with bank in partnership with non-government organizations (NGO) for promoting SHG of socio-economically homogenous members. In 1992 the launching of pilot phase of SHG-BANK LINKAGE PROGRAMS (SHG-BLP) could be considered as a landmark development in banking with the poor. In order to promote this programs

Reserve Bank of India issued instructions to banks in 1996 to cover SHG financing as a mainstream activity under their priority from 1999 through government of India budget announcements. These days many Private Commercial Banks, Regional Rural Banks, Societies, Trusts are providing microfinance by using their branch network and through different microfinance delivery models.

## FACTORS THAT BRING MICROFINANCE AS A POLICY IN INDIA

In India, Institutional credit agencies (banks) made an entry in rural areas initially to provide an alternative to the rural money lenders who provided credit support, but not without exploiting the rural poor.

There are three main factors that count to the bringing up of Microfinance as a Policy in India:

- 1) The first of these pivotal events was Indira Gandhi's bank nationalization drive launched in 1969 which required commercial banks to open rural branches resulting in a 15.2% increase in rural bank branches in India between 1973 and 1985. Today, India has over 32,000 rural branches of commercial banks and regional rural banks, 14,000 co-operative bank branches.
- 2) The second national policy that has had a significant impact on the evolution of India's banking and financial system is the Integrated Rural Development Program (IRDP) introduced in 1978 and designed to be "a direct instrument for attacking India's rural poverty".
- 3) The last major event which impacted the financial and banking system in India was the liberalization of India's financial system in the 1990s characterized by a series of structural adjustments and financial policy reforms initiated by the Reserve Bank of India (RBI).

## APPROACHES OF MICROFINANCE

Indian microfinance is dominated by two operational approaches viz.

- 1) Self-help groups (SHGs)
- 2) Micro-finance institutions (MFIs)

The first approach is popularly known as SHG-Bank linkage model. This model is the dominant model, initiated by the NABARD through the SHG-Bank linkage programme in the early 1990s. Today the SHG model also links the informal groups of women to the mainstream system and it has the largest outreach to micro financial clients in the world.

The second approach also called financing through MFIs is the emerging model. This model emerged in the late 1990s to harness social and commercial funds available for open-lending to clients. Today there are over 1,000 Indian MFIs. These institutions assume the responsibility of making available much needed micro credit to the poor section of the society. Generally MFIs/NGOs take on the additional role of financial intermediaries. In areas where the formal banking system faces constraints, the NGO are encouraged to approach a suitable bank for bulk loan assistance. This, in turn is used by the MFI/NGO for lending to the SHGs in areas where a large number by of SHGs have been financed by bank branches, intermediate agencies like federations of SHGs are coming up as links between bank branch and member SHGs. These federations are financed by banks, which in turn, finance their member SHGs.

## **CHANNELS OF MICRO FINANCE**

In India microfinance operates through two channels:

- (1) SHG-Bank Linkage Programme (SBLP)
- (2) Micro Finance Institutions (MFIs)
- (1) **SHG-Bank linkage programs:** This is the bank- led microfinance channel which was initiated by NABARD in 1992. 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. In the later period these SHGs are provided with bank loans generally for income generation purpose. 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.
- (2) **Micro-finance institutions:** Those institutions which have microfinance as their main operation are known as micro finance Institutions. 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 Joint Liability Group is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee.

The reason for existence of separate institutions i.e. MFIs for offerings microfinance are as follows:

High transaction cost: Generally micro credits fall below the break-even point of providing loans by banks.

Absence of collaterals: The poor usually are not in a state to offer collaterals to secure the credit.

Loans are generally taken for very short duration periods

Higher frequency of repayment of installments and higher rate of default.

Non-Banking Financial Companies (NBFCs), Co-operatives societies, Section-25 companies, Societies and Trusts, all such institutions operating in microfinance sector constitute Microfinance Institutions (MFIs) and together they account for about 42% of the microfinance sector in terms of loan portfolio. The MFI channel is dominated by NBFCs which cover more than 80% of the total loan portfolio through the MFI channel.

## **REFERENCES**

- Shahnawaz (2010). "Microfinance and poverty reduction" Available at: <https://www.google.co.in/search?q=Shahnawaz%2C+Microfinance+and+poverty+reduction%2C2010.&ie=utf-8&oe=utf-8&aq=t&rls=org>.
- Swaminathan, Madhura (2007). "Micro-credit alternatives", Economic and Political Weekly, Vol. No. 13, p. 1171.
- Vasimalia, M.P and Narender, k. (2007). "Microfinance for poverty eradication" Economic and Political Weekly, Vol. No. 13, p. 1190.

---

### **Corresponding Author**

**Rakesh Kumar\***

Research Scholar, Singhania University, Pachari Bari, Rajasthan

E-Mail – [rakeshksharmaca@gmail.com](mailto:rakeshksharmaca@gmail.com)