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Development of Microfinance in India

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Abstract – Indian microfinance is dominated by two operational approaches.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.

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INTRODUCTION

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.

APEX FINANCIAL INSTITUTIONS

The formal microfinance service providers include a number of apex financial institutions. Some of them are like National Bank For Agriculture and Rural Development (NABARD), Small Industries Development Bank Of India (SIDBI), Rashtriya Mahila Kosh (RMK), Friends Of Women World Banking (FWWB), Housing Development Finance Corporation (HDFC), Housing and Urban Development Corporation Limited (HUDCO) and Rashtriya Gramin Vikas Nidhi (RGVN). They provide bulk amount of funds to retail level banks and MFIs for on-lending to the poor. There are different terms and conditions associated with each apex financial institute. In addition to these apex financial institutions, many MFIs get funds from investors, lenders and donors also.

Table: - 1.1

Legal Forms of MFIs in India

Sr. No.		Number	Legal Acts under which Registered
1.	Non- Profit MFIs		

(a)	NGO-MFI	400-500	Societies Registration Act, 1860 Indian Trust Act, 1882.
(b)	Non-profit Companies	10	Section -25 of Indian Companies Act, 1956.
2.	Mutual Benefit MFIs		
	Mutually Aided Co-operative Societies (MACS)and similarly set up institutions	200-250	Mutually Aided Co-operative Societies Act enacted by state governments
3	For Profit MFIs		
	Non-banking Financial Companies (NBFCs)	06	Indian Companies Act, 1956. Reserve Bank of India Act, 1934.
	Total	700-800	

Source: *Nabard Issues Related To Microfinance*

The table exhibits that the number of registered MFIs in India are estimated to be around 700-800 as no published data is available on private MFIs operating in the country. Majority of the MFIs are operating on small-scale with clients ranging between 500 to 1500 per MFI and not more than 10 MFIs have an outreach of 1 lakh microfinance clients.

The different organizations in this field can be classified as “mainstream” and “alternative” MFI.

Mainstream Micro Finance institutions: NABARD, Small Industries Development Bank of India (SIDBI), Housing Development Finance Corporation (HDFC), Commercial Banks, Regional Rural Banks (RRBs) etc. are some of the mainstream financial institutions involved in extending micro finance.

Alternative Micro Finance Institution: These are the institutions, which have come up to fill the gap between demand and supply for microfinance. Microfinance institutions were recently defined by the Task Force as “those which provide thrift, credit and other financial services and products of very small amounts, mainly to the poor, in rural, semi-urban or urban areas for enabling them to raise their income level and improve living standards.

Top 10 Microfinance Institutions in India by Loan Amount Outstanding as per CRISIL rating.

1) SKS Microfinance Ltd. (SKSMPL).

2) Spandana Sphoorty Financial Ltd. (SSFL).

3) Share Micro finance Limited (SML).

4) Asmitha Micro finance limited (AML).

5) Shri kshetra Dharmasthala Rural Development Project (SKDRDP)

6) Bhartiya Samruddhi Finance Limited (BSFL).

7) Bandhan Society.

8) Cashpor Micro Credit (CMC).

9) Grama Vidiyal Micro Finance Pvt. Ltd. (GVMFL).

10) Grameen Financial Services Pvt. Ltd. (GFSPL).

ROLE OF MICRO FINANCE IN INDIA

In India, economic reforms with a human face have been accepted as the guiding principle of sustainable development. Keeping the poor at centre stage, the policies need to be reoriented so as to develop and optimize the potential of such a large segment of the population and enable them to contribute in the growth process significantly in terms of output, income, employment and consumption. Viewed from this angle, our survey results show that, Micro-Finance can be a powerful instrument initiating a cyclical process of growth and development.

Micro-Finance activity improved access of rural poor to financial services, both savings and credit. Increased access signifies overcoming isolation of rural women in terms of their access to financial services and denial of credit due to absence of collateral. The pool of savings generated out of very small but regular contributions improved access of the poor women to bank loans. It could also help in strengthening poor families’ resistance to external shocks and reducing dependence on moneylenders.

DELIVERY MODELS OF MICROFINANCE

The concept of microfinance involves informal and flexible approach to the credit needs of the poor. There is no single approach or model that fits in all the circumstances. Therefore, a number of microfinance models emerged in different countries/states according to the suitability to their local conditions. Broadly, the microfinance delivery methods can be classified into five groups as follows –

(1) **Group Based Model:** Within the group based category, there are two sub-categories self-help group (SHG) and the Grameen Bank Model .Of these two models, the SHG model is most commonly used by the organizations in India. In this model high emphasis is given on saving and credit activities. The SHG-Bank Linkage Programs adopted by NABARD with partner agencies has emerged as an attractive mode of credit delivery model. Apart from SHG-Bank Linkage Programs, many NGOs are using a variety of delivery mechanism (including adaptation of Bangladesh Grameen Bank) for providing micro credit services with financial support from external donors and other apex institutions, including Rashtriya Mahila Kosh (RMK) set up by the government and SIDBI foundation for micro credit set up by a sister apex development institution.

2) **Non-Banking Financial Corporation Model**: This model has the belief that poor are bankable and lending to them is commercially viable. This model works on banking principles with focus on both saving and credit activities. Financial services are provided to the clients either directly or through SHG. The core element of this model is profit making with strict financial disciple. In India this type of delivery model is very popular in the corporate world.

(3) **Wholesale Banking Model**: The wholesale banking model seeks to assists many NGOs making previously on non- financial development issues like poverty, health, literacy, eco-restorations etc., but that have now taken microfinance as an add on programs. MFIs adopting this model act as second tier MFIs. The model has the feature of promptness and unique package of providing both loans and capacity building support to its partner. The model entails making loans to financial intermediaries in the form of NGOs/MFIs/SHG federations rather than directly to group or members.

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