MICRO FINANCE IN INDIA ACCOMPLISHMENTS AND CHALLENGES

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Abstract: *Micro finance is emerging as the most viable route to extend financial services to the poor. The self-help group (SHG) model with banks often lending to groups of poor women without collateral has become an accepted part of rural finance. The purpose of this paper is to examine the role of micro finance in the empowerment of people in India. With traditionally loss-making rural banks shifting their portfolio away from the rural poor in the post-reform period, SHG-based micro finance, nurtured and aided by NGOs, has become an important alternative to traditional lending in terms of reaching the poor without incurring much operating and monitoring costs. Having recognized this, the government and NABARD have emphasized the SHG approach and are working along with NGOs in its initiatives. Over 22 lakh of SHGs are in existence in India today, providing the basic grass root-level institutional support. In spite of the impressive figures, micro finance in India is still presently too small to create a massive impact on poverty alleviation, but if pursued with skill and opportunity development of the poor, it holds the promise to alter the socioeconomic face of India's poor.*

Keywords :
Micro Finance, Micro Credit, SHGs, MFIs, NGOs.

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INTRODUCTION

Credit is one of the critical inputs for economic development. Its timely availability in the right quantity and at an affordable cost goes a long way in contributing to the well being of the people especially in the lower rungs of society. It is one of the three main challenges to input management in agriculture, the other two being physical and human (Hans, 2006). Thus access to finance, especially by the poor and vulnerable groups is a prerequisite for employment, economic growth, poverty reduction and social cohesion. Further, access to finance will empower the vulnerable groups by giving them an opportunity to have a bank account, to save and invest, to insure their homes or to partake of credit, thereby facilitating them to break the chain of poverty. But India is lagging behind in this respect; so it has become a matter of concern.

In the case of India, the banking sector witnessed a large scale branch expansion after the nationalisation of banks in 1969, which facilitated a shift in focus of banking from class banking to mass banking. It was, however, realised that, without the expansion of formal financial institutions, these institutions would not be able to cater completely to the small and frequent credit needs of most of the poor. This led to a search for alternative policies and reforms for reaching out to the poor to satisfy their credit needs.

The beginning of the micro finance movement in India could be traced to the self help group (SHG) - bank linkage programme (SBLP) started as a pilot project in 1992 by National Bank for Agricultural and Rural Development (NABARD). This programme not only proved to be very successful, but has also emerged as the most popular model of micro finance in India. Other approaches like micro finance institutions (MFIs) also emerged subsequently in the country.

Recognizing the potential of micro finance to positively influence the

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development of the poor, the Reserve Bank, NABARD and Small Industries Development Bank of India (SIDBI) have taken several initiatives over the years to give a further fillip to the micro finance movement in India.

Objectives

The objectives for this paper are as follows:

- To analyse the history of lending to the poor and the emergence of the concept micro finance in India.
- To explain the Micro Finance delivery models in India
- To enumerate the progress of Micro Finance in India
- To evaluate the future prospects and challenges.

I. The Banking Sector and lending to the rural poor – A Background

After independence, the structure of rural credit institutions, with co-operative bank and mortgage bank have been catering to short term and long term credit needs respectively. The assessment of performance of co-operative by All India Rural Credit Survey Committee in 1954 highlighted the fact that volume of credit supplied by the cooperative movement was insignificant, accounting only 3 per cent of the total borrowing of cultivators. It revealed that the share of Institutional agencies, comprising the Government, the co-operative and commercial banks in financing the borrowings of rural household was only 7.3per cent in 1951-52 corresponding to the share of private money lenders was high as 68.6per cent (Lalitha, 1998).

The Nationalization of SBI in 1955 had drawn it into rural banking. But other commercial banks kept away from it. The All India Rural Credit Review Committee appointed by RBI under the chairman, B. Venkatappaih, which submitted its report in 1969, showed the inadequacy of co-operative system alone to meet the credit requirements of rural sector.

The financial sector developed in India by the late 1980s was criticized as largely target and supply driven. The Committee prepared the multi agency approach to rural finance. It was only with social control banks in late 1960s and Nationalization of 14 commercial banks in 196! , followed by 6 more in 1980, that rural orientation of commercial banks started in a systematic way. (Lalitha, 1998) In 1980-81 the Government initiated Integrated Rural Development Programme (IRDP) with the objective of directing subsidized loan to poor self-employed people through banking sector. High default rates; corruption and high degree of suspicion among bankers about the credit worthiness of poor people were the major features of the time. Savings products were inflexible and inappropriately designed and appropriate insurance products were few and far between. On the credit side, the rural borrowing supplied by informal sources fell to 40 per cent in1991, household with the least assets were far more dependent on informal sources (Mahajan, 2000, cited in Sriram and Fisher). Borrowers faced high transaction costs to secure subsidized loans, pushing their real cost from 22 to 33 percent.

Fisher and Sriram point out that formal

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financial sector is not successful to recognize the divergence between the hierarchies of credit needs and credit availability. The result is the adverse use of credit. Credit use start with consumption purpose, which are only being met, through informal sources at high cost. Higher needs come in to play when the lower needs are satisfied. However credit (often subsidized rate) is usually available for new enterprises (i.e. for diversification). Money is fungible; therefore the loan taken for diversification is being used in lower rungs of hierarchy. This implies that any appraisal of loan is not honoured resulting in the adverse usage and hence adverse repayment performance (Fisher and Shriram, 2002).

In 1991, the macro economic conditions propelled the government to introduce structural changes in the economy, commonly referred to as economic reforms of 1991.

The success of few Non Governmental Organisations (NGOs) like Mysore Resettlement and Development Agency (MYRADA) in group lending, made the government in shifting the strategy of women development and empowerment under Development of Women and Children in Rural Areas (DWCRA) programme. (Rajshekar, 2004). Thus group based approach started in a very modest manner. However, the first interest in informal group lending in India took shape during 1986-87 on the initiative of NABARD. This apex bank for rural development, took a research project on SHGs as a channel for delivery of micro finance in the late 1980s. Amongst these MYRADA sponsored research project on 'Savings and credit management' of SHGs was partly funded by National bank for Agriculture and Rural Development (NABARD) in 1986-87. In the very next year, in association with Asia Pacific Rural and Agricultural Credit Association' (APRACA), the bank (NABARD) undertook a survey of 43 NGOs in 11 states, to study the functioning of micro finance Self Help Groups (SHG) and their collaboration possibilities with the formal banking system. Both these research projects threw up encouraging possibilities and NABARD initiated a pilot project called SHG-bank linkage project (Satish 2005, NABARD 1991).

In 1991, the macro economic conditions propelled the government to introduce structural changes in the economy, commonly referred to as economic reforms of 1991. Karmakar remarked that the immediate impact of reform to the financial sector become necessary by 1990s have in many ways made things worse for the poor people. There has been a drastic fall in rural credit. The share of rural credit in the total credit disbursement by commercial banks, which grew from 3.5 to 15 percent form 1971 to 1991, has now declined again to 11 percent in 1998 (Sa- Dhan, 2004).

Even after the institutional finance came into being and as banking sector emerged, the need for 'micro' credit characteristically for the poor section of the society was not met by the formal banking sector. The nature of formal banking sector, with its emphasis on 'collateral based lending', could not cater to the needs of smaller borrowers, especially women, who were typically resource poor and possessed negligible assets to offer as collateral. Given the male dominated rural society, prior to 1990s there were hardly any credit schemes designed for rural women (Karmakar, 2002).

All these development resulted in a fall in the availability of credit from formal financial system, leaving informal

sources as well as SHGs and MFIs to fill this gap (Fisher and Sriram, 2002). Even the government policies have stared focusing from development towards empowerment of women through group-based approach.

II. Micro finance: Meaning and Delivery Models

Micro finance (MF) in the recent past has emerged as a potential instrument for poverty alleviation and women empowerment. MF intervention refers to provision of access to small loans without physical collateral to the poor, especially the women, while encouraging them to save regularly in order to combine thrift and self-help for their own development. MFIs consist of Refinance Institutions, Banks, Non Government Organisations and Self Help Groups dealing with small loans and deposits in rural, semi-urban or urban areas enabling people to raise savings, productive investments and, thereby, their standard of living (Nadarajan and Ponmurugan, 2006).

The non-availability of credit and banking facilities to the poor and underprivileged segments of the society has always been a major concern in India. Accordingly, both the Government and the Reserve Bank have taken several initiatives, from time to time, such as nationalization of banks, prescription of priority sector lending norms and concessional interest rate for the weaker sections. It was, however, realised that further direct efforts were required to address the credit needs of the poor. In response to this requirement, the micro finance movement started in India with the introduction of SHG Bank Linkage Programme (SBLP) in the early 1990s. At present, there are two models of micro finance delivery in India: the SBLP model and the MFI model. The SBLP model has emerged as the dominant model in terms of number of borrowers and loans outstanding. In terms of coverage, this model is considered to be the largest micro finance programme in the world.

SHG-Bank Linkage Programme

The micro finance sector started getting recognition in India after the launch of the SBLP. Under the SBLP, the following three different models have emerged:

Model I: SHGs promoted, guided and financed by banks. This model covers about 20% of the total of about 3.5 million groups that are linked to banks in India.

Model II: SHGs promoted by NGOs/ Government agencies and financed by banks. This, by far, is the largest model in India, covering 72% of the total groups linked to banks in India.

Model III: SHGs promoted by NGOs and financed by banks using NGOs/formal agencies as financial intermediaries. In this model, the NGO-MFI receives bulk loan from the bank. The bank, in turn, delivers the same to groups and in the process charges some service fee from SHGs. This model covers about 8% of the total groups and is expected to grow in future.

Commercial banks, co-operative banks and the regional rural banks have been actively participating in the SBLP.

The non-availability of credit and banking facilities to the poor and underprivileged segments of the society has always been a major concern in India.

While the SBLP has emerged as the most dominant model, the MFI model has also been gaining importance.

Micro Finance Institution Approach

The MFI model in India is characterised by a diversity of institutional and legal forms. MFIs in India exist in a variety of forms like trusts registered under the Indian Trust Act, 1882/Public Trust Act, 1920; societies registered under the Societies Registration Act, 1860; Co-operatives registered under the Mutually Aided Cooperative Societies Acts of the States; and non banking financial companies (NBFC)-MFIs, which are registered under Section 25 of the Companies Act, 1956 or NBFCs registered with the Reserve Bank. These MFIs are spread across the country and due to the multiplicity of registering authorities, there is no reliable estimate of the number of MFIs. The most frequently used estimate is that their number is likely to be around 800.

Bank Partnership Model

Banks can use MFIs as their agent for handling credit, monitoring, supervision and recovery. In this model, the bank is the lender and the MFI acts as an agent for handling items of work relating to credit monitoring, supervision and recovery, while the borrower is the individual. The MFI acts as an agent – it takes care of all relationships with the client, from first contact through final repayment. Another variation of this model is where the MFI, an NBFC, holds the individual loans on its books for a while, before securitizing them and selling them to the bank. Such refinancing through securitisation enables the MFIs a greater funding access.

Banking Correspondents

In January 2006, the Reserve Bank permitted banks to utilise the services of NGOs, MFIs (other than NBFCs) and other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models. The BC model allows banks to do 'cash in – cash out' transactions at a location much closer to the rural population, thus addressing the last mile problem. The BC model uses the MFI's ability to get close to poor clients – a necessity for savings mobilisation from the poor – while relying on the financial strength of the bank to safeguard the deposits. Pursuant to the announcement made by the Union Finance Minister in the Union Budget 2008-09, banks have been permitted to engage retired bank employees, ex-servicemen and retired government employees as business correspondents (BCs) with effect from April24, 2008, in addition to entities already permitted earlier, subject to appropriate due diligence.

III. Progress of Micro Finance in India

The micro finance movement has come a long way since its inception in the early 1990s and has assumed enormous significance in the delivery of credit to the hitherto excluded sections of the population. While the SBLP has emerged as the most dominant model, the MFI model has also been gaining importance.

The SBLP has made considerable progress since its inception in the early 1990s, both in terms of the number of SHGs credit linked with banks as also

the bank loans disbursed by SHGs. The cumulative number of SHGs credit linked with banks increased sharply from 33,000 in 1992-99 to 2,64,000 in 2000-01 and further to 22,39,000 in 2005-06. During the above period, the cumulative bank loans disbursed to SHGs also witnessed a sharp increase from Rs. 57 crore in 1992-99 to Rs.481 crore in 2000-01 and further to Rs.11,398 crore in 2005-06 (Table 1).

Table 1: SHG -Bank Linkage Programme (Rs in crores)

Year	Total SHGs financed by Banks(in '000s)		Bank Loans		Refinance	
	During the year	Cumulative	During the year	Cumulative	During the year	Cumulative
1992-99	33	33	57	57	52	52
1999-00	82	115	136	193	98	150
2000-01	149	264	288	481	244	394
2001-02	198	461	545	1026	395	790
2002-03	256	717	1022	2049	622	1412
2003-04	362	1079	1856	3904	705	2118
2004-05	539	1618	2994	6898	968	3086
2005-06	620	2239	4499	11398	1068	4153
2006-07	1106	-	6570	-	1293	5446
2007-08	740	-	4228	-	1616	7062

Source: Report on Trend and progress of banking in India 2007-08
- Not available

The data available so far indicates that during the year 2007-08, 5,52,992 new SHGs were provided with bank loan and 1,86,883 existing SHGs with repeat loans. Total bank loans disbursed during the year were at Rs.4,228 crore, of which repeat bank loans to existing SHGs were at Rs.1,686 crore. The growth of number of SHGs has decelerated in recent years, particularly in the southern region, where rapid progress was made earlier. The scheme is catching up slowly in the northern region. The MFIs have also expanded their operations, which might have impacted the growth of the SBLP to some extent.

In terms of relative shares of different agencies, commercial banks continued to account for the largest share, both in terms of number of SHGs credit linked and bank loans disbursed, followed by regional rural banks and co-operative banks (Table 2).

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Table 2: Agency-wise SHG –Bank Linkage Position

(Rs in crores)

	SHGs Credit Linked (in '000)		Bank Loans Disbursed	
Agency	2006-07	2007-08	2006-07	2007-08
Commercial Banks	575(52)	312(42)	3919(60)	2043(48)
RRBs	381(34)	241(33)	2053(31)	1599(38)
Co-operative Banks	153(14)	187(25)	599(09)	586(14)
Total	1106(100)	740(100)	6570(100)	4228(100)

Source: Report on Trend and progress of banking in India 2007-08

• Figures put in bracket are percentages share in the respective total.

Commercial banks had the maximum share of the SHG's savings (53.9 per cent), followed by RRBs (32.9 per cent) and co-operative banks (13.2 per cent).

Among the commercial banks, public sector banks accounted for the largest share of loans disbursed to SHG sector (88.8 per cent) in 2006-07. Out of the total loans disbursed by the commercial banks, 86.9 per cent of the loans were disbursed exclusively to women SHGs. Under the SBLP, as on March 31, 2007, 2.9 million SHGs had outstanding bank loans of Rs.12,366 crore (Table 3).

Table 3: Bank Loans Outstanding under SBLP

(Amount in Rs. crore)

Agency	No. of SHGs	Loans Outstanding
Commercial Banks	18,93,016 (65.4)	8,760 (70.8)
RRBs	7,29,255 (25.2)	2,802 (22.7)
Co-operative Banks	2,75,234 (9.4)	804 (6.5)
Total	28,94,505 (100)	12,366 (100)

Source: Report on Trend and progress of banking in India 2007-08

• Figures put in bracket are percentages share in the respective total.

As on March 31, 2007, the number of SHGs maintaining savings bank accounts with the banking sector was 4.2 million with outstanding savings of Rs. 3,513 crore, thereby covering more than 58 million poor households under the programme. Commercial banks had the maximum share of the SHG's savings (53.9 per cent), followed by RRBs (32.9 per cent) and co-operative banks (13.2 per cent) (Table 4). Among the commercial banks, the public sector banks accounted for the largest share of savings (95.9 per cent), while private sector banks accounted for marginal share (4.1 per cent). It is noteworthy that around 87.3 per cent of the savings were by exclusive women SHGs.

Table 4: Savings of SHGs with Banks (as on March 2007)

(Amount in Rs crores)

	Total Savings		Exclusive Women SHGs	
Agency	No of SHGs	Amount of O/s Savings	No of SHGs	Amount of O/s Savings
Commercial Banks	2,293,771	1,892	1,794,720	1,651
Percentage	55.1	53.9	54.9	54.6
RRBs	1.183,065	1,158	9,74,811	1043
Percentage	28.4	32.9	29.8	34.5
Co operative Banks	683,748	462	501,708	331
Percentage	16.4	13.2	15.3	10.9
Total	4,160,584	3,513	3,271,239	3,025
Percentage	100	100	100	100

Source: Report on Trend and progress of banking in India 2007-08

About 37 per cent of banks reported recovery of above 95 per cent under the programme, 36 per cent banks reported recovery in the range of 80-94 per cent and another 20 per cent banks reported recovery in the range of 50-79 per cent. Some differences were observed in recovery rates of commercial banks, co-operative banks and regional rural banks (Table 5). While the recovery rate of public sector banks varied between 52 per cent and 99 per cent, and that of private sector banks varied between 60 per cent and 100 per cent. Out of the 26 private sector banks, the recovery rate of four banks was 100 per cent.

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Table 5: Recovery Performance of Bank Loans to SHGs

(Amount in Rs Crores)

Agency	No of reporting banks	Recovery performance of bank loans to SHGs			
		95% and above	80%-94%	50%-79%	< 50%
Commercial Banks	36	11	15	10	0
Percentage		30.6	41.7	27.8	0
RRBs	73	20	35	13	5
Percentage		27.4	47.9	17.8	6.8
Co-operative Banks	181	76	55	35	15
Percentage		42	30.4	19.3	8.3
Total	290	107	105	58	20
Percentage		36.9	36.2	20	6.9

Source: Report on Trend and progress of banking in India 2007-08

Many groups promoted under various Government sponsored programmes also constituted a part of the SBLP. As on March 31, 2007, the number of SHGs having outstanding bank loans under the Swarnjayanti Gram Swarozgar Yojana (SGSY) were at seven lakh constituting 23.7 per cent of the total SHGs under the SBLP. The loan amount outstanding under these SGSY loans was Rs.3,273 crore which constituted 26.5 per cent of the total amount outstanding under the SBLP.

IV. The Road Ahead – Prospects and Challenges

In this paper the effort has been put to provide a bird's-eye view of the micro finance sector in India. There have definitely been significant advances in recent years and the concept and practice of SHG-based micro finance has now developed deep roots in many parts of the country. Impact assessment being rather limited so far, it is hard to measure and quantify the effect that this Indian micro credit experience so far has had on the poverty situation in India. Doubtlessly, a lot needs to be accomplished in terms of outreach to make a serious dent on poverty. It is a challenge for the MFIs to identify the poor and to reach them, due to heterogeneity of poor and general lack of entrepreneurship among them. Experience shows that the participatory processes are better than top-down approaches for the identification of the poor in general. However, the logic and rationale of SHG based micro finance have been established firmly enough for micro credit to effectively graduate from an "experiment" to a widely-accepted paradigm of rural and developmental financing in India. This is no mean achievement. In fact, to the extent that people's mindset is the biggest roadblock in the success of an innovation, it may well be one of the most important steps in the saga of micro finance.

The path ahead is obviously strewn with challenges. Scaling up of projects and bringing millions of people within the fold of micro finance is no mean task. The most convincing feature of this form of financing that justifies its admittedly higher costs is the near-perfect repayment rates. The expansionary zeal of micro credit practitioners should be balanced with the quality of loans – indeed a momentous challenge. Government involvement in SHG-based micro finance is a welcome development but it is not free from its ills. Government aid almost always brings in its wake political favoritism and corruption. It is important to ensure that the government micro finance initiatives do not go the way of their several well-intentioned predecessors.

The biggest challenge in development, however, is the simultaneous development of investment potential and improvement of skill levels of the borrowers.

The biggest challenge in development, however, is the simultaneous development of investment potential and improvement of skill levels of the borrowers. A glut of low skilled services is an unwelcome substitute for scarcity of credit. As micro credit alleviates the credit availability problem, the need for micro-consulting, business planning and services like marketing are being felt with greater acuteness. Micro credit cannot be expected to be a panacea to rural developmental problems. In some sense, its role is similar to that of credit in the general economy. It is a string that can hold back progress, but it is almost impossible to push on a string. There is a very real need of investments that yield

higher returns than the sustainable micro credit interest rates for the micro credit initiative to be truly successful. Promotion of individual and group enterprises with backward and forward linkage poses an ongoing challenge for the policy makers.

The issue of poverty reduction in the real sense is a challenging task. The impact on poverty reduction has to be deeper and wider. Regulation related challenges call for appropriate institutional form, reducing over-lapping of clients by providers, streamlining deposit function, regulating micro finance operations of NGO-MFIs and measures to be taken in case of default when group pressure fails.

However, so far the evidence - largely anecdotal – points to the several beneficial side-effects of micro credit. In particular, empowerment of women and the inculcation of financial training and discipline amongst the poor will undoubtedly have long-term socioeconomic benefits. The principles of self-help and micro credit thus hold the key to economic and socio-cultural freedom for India's millions of poor, opening the gates of a hitherto untapped reservoir of human enterprise. The renewed focus on inclusive growth at the national policy level is timely as it provides an impetus to the micro finance services. The challenges that the micro finance sector faces must be addressed for an all round development of rural areas.

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