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Drivers of Microfinance in India: An Exploratory Study

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Abstract:

The evolutionary concept of microfinance came into being in 20th century as an alternate to traditional financial services offered by banks. The objective of microfinance was to help vulnerable section of society who remained outside the formal banking sector. The system proved to be beneficial for downtrodden and neglected section which was formally considered non-bankable by banks and financial institutions. Various studies show different forms of microfinance institutions, their legal structures, its working and also highlight how this new programme (microfinance) bridges the gap by helping the poor and needy section of society. Through this paper researcher try to review the existing literature and explore the drivers of microfinance in India. The microfinance as an instrument of socio-economic change is also helpful in achieving long sought goal of financial inclusion and has to go a long way. Government, policymakers and institutions should come forward for a sound and robust system where more and more people are included in financial ambit through microfinance and social mission they have initiated can be achieved for creating positive externalities.

Key words: Microfinance, SHG, NABARD, Interest Rates and Interest-Free Microfinance.

1. Introduction

India has predominantly been an agrarian economy with approximately two-thirds of its population is engaged in agriculture & allied activities like farming, cattle rearing etc. A feature of this sector is that, the engaged workforce need small and frequent doses of credit that are hassle free for consumption and emergency purposes but they do not have regular cash inflows. Despite nationalization of banks and wide network of branches across the country, the banks were not able to connect the people and a large number of population remained outside the formal banking system which led to the problem in channelizing the savings of rich and middle class towards the needy section and they continued to be exploited due to the existence of indigenous money lenders/ informal money market, charging high interest rate without any transparent business rules.

Unlike developed countries, where the financial institutions have provided the vast majority of the population with bank accounts, there has been lack of government initiative in developing countries and traditional outreach modes like physical branch network have been inappropriate due to the high operational costs involved and regulatory framework to provide the masses with easy access to capital. To overcome the said problem in developing countries like India microfinance has come as a breakthrough in the philosophy and practices of poverty eradication, financial inclusion, economic empowerment and inclusive growth. Over the last several years it has helped the poor to increase their income, build viable businesses and reduce their vulnerability to external shocks.

Microfinance means providing financial services like savings, credit, loans and insurance to the low-income group or poor people who do not have access to banking services. The

Reserve Bank of India has defined microfinance as a provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improving living standards. Malegam Sub-Committee defined Microfinance as an economic development tool whose objective is to assist the poor to work their way out of poverty. It covers a range of services which include, in addition to the provision of credit, many other services such as savings, insurance, money transfers, counseling, etc. Microfinance encompasses a broad range of services such as deposits, loans, payment services, and insurance to poor and low-income groups and micro-enterprises. Microfinance offers poor people access to basic financial services such as Micro-Credit, Micro-Savings, and Micro-Insurance. It embraced a range of financial services that seek to meet the needs of poor people, both protecting them from fluctuating incomes and other shocks and helping to promote their incomes and livelihood. It can be said that it bridges the gap by providing financial services to those who are unable to access the formal financial system and provides a successful platform which can better serve the needs at various levels and benefit people to establish small businesses. It has become an interesting field of study when United Nations declared 2005 to be international year of Microcredit; and after Mohammad Yunus and Grameen Bank jointly awarded the Nobel Peace award in 2006 for their relentless efforts to create socio-economic development in Bangladesh and gained attention of academicians, researchers, philanthropists and policy makers across the world. Various studies show that it has emerged as a powerful instrument for poverty alleviation and financial inclusion in developing economies.

Finally it can be said that microfinance bridge the gap by providing financial services to the destitute section, who were considered un bankable and proved a successful platform which can better serve the needs of this section. The programme is an important conduit not only in poverty alleviation and bringing the gender equality but also helped people to establish small businesses.

2. Literature Review

A much has been written on microfinance and different researchers have their own opinion. According to Singh (2008), microfinance services are designed to help the underprivileged to increase their earning, consolidate their properties and even gain a decent financial stability in life. The advantage of availing the microfinance credit over the more traditional means is the unwillingness of the later to serve the underprivileged people.

Gurumoorthy (2000) explained the Self Help Group (SHG) as a viable alternative to achieve the objectives of rural development and to get community participation in all rural development programmes. It was an organized set up to provide micro-credit to the rural women on the strength of the group savings without insisting on any collateral security for the purpose of encouraging them to enter into entrepreneurial activities and for making them enterprising women. Anjugam and Alagumani (2001) concluded that microfinance has brought considerable improvement in decision making skills among women, gave them confidence in managing the financial crisis of the family, decision making capacity in household matters and assertiveness in protesting against social evils like drinking water problem, dowry and gambling etc.

Swainan and Fan Yang (2009) strongly concluded in their study that SHG members were empowered by participating in microfinance program in the sense that they could have a greater propensity to resist existing gender norms and culture that restrict their ability to develop and make choices.

Cull et al. (2008) found that there is a remarkable success in maintaining high rates of loan repayment in microfinance sector, but their study also suggests that profit-maximizing investors would have limited interest in most of the institutions that are focusing on the poorest customers and women. Those institutions, as a group, charge their customers the highest fees in the sample but also face particularly high transaction costs, in part due to small transaction sizes.

Shastri (2009) showed that the dynamic growth of the microfinance industry has been promoted not only by market forces but also by conscious actions of national governments, Non-Governmental Organizations (NGOs), and the donors who view microfinance as an effective tool for eradicating poverty. Kumar et al (2010) showed that the potential for growing microfinance institutions in India is very high. Major cross-section can have benefit if this sector will grow in its fastest pace. The study predicts annual growth rate of about 20 % during the next five year.

Shetty and Veerashekharappa (2009) studied the importance of microfinance in bringing about financial inclusion. They said the impact of the increasing gap in demand and supply of financial services in India which has led to the increasing population of the country to be excluded from the formal financial credit system.

3. Research Methodology

3.1 Research Gap

The reviewed literature has no doubt thrown some valuable light on the various models prevalent across the developed/ developing nations in general and particular in India. The programme has gained universal acceptance. However, it can rise to greater heights. On the basis of the various studies in the field of microfinance, their operations, legal structures, their impact on socio economic conditions of people and recovery practices it has been found that there is hardly any study on the drivers which paved the way for microfinance in India. Towards this end, the reviewed literature suffers from a gap. Through this paper an attempt has been made to explore those factors which derive the growth of microfinance in India.

3.2 Need for the Study

India is an agro-based economy and a large section of society is remained outside the formal banking system. Initiatives like SEWA, SKS Microfinance, Bandhan SHG Bank Linkage programme of NABARD etc. came into existence to provide small loans to unbanked section. It gave a push to Indian microfinance sector which is still growing and it is now necessary to understand the difference between various models of microfinance & their functioning and also the factors that influence the growth of microfinance, coverings a vast majority of poor people where the formal banking system was lagging behind. It is in this backdrop that this study "Drivers of Microfinance in India: An Exploratory Study" has become necessary.

3.3 Scope of the Study: The study will confine itself to various factors which are associated with microfinance sector in India only.

3.4 Objectives of the Study

The objectives of the study are to:

- To understand various models in the field of microfinance.
- To identify the different operation, lending and repayment system of different microfinance institutions.
- To identify the factors that influence growth of microfinance.

3.5 Type of Study: This study is Doctrinal Research and Exploratory in nature.

3.6 Sources of Data: Based upon secondary data, which is being collected from various research papers/articles, journals, working papers, government reports etc.

4. Analysis:

4.1 Types of Micro Finance

The agencies operating in the field of microfinance have almost similar product offerings i.e. provision of small amounts to the needy section of society, microcredit and micro insurance etc. But the nature of their legal existence, lending operations, repayment and working is not similar and they can be differentiated on following basis.

- Legal Structure
- Lending Model
- Loan repayment
- Product offering

The Microfinance Institutions can broadly be classified as under different forms:

[1] Not for Profit:

A. NGO MFI-registered under the *Societies Registration Act*, 1860 or the *Indian Trusts Act*, 1882.

B. NBFC MFIs incorporated under Section 25 of Companies Act, 1956.

[2] Mutual Benefit: Cooperative MFIs – registered under the State Cooperative Societies Act or Mutually Aided Cooperative societies Act, MACS or Multi State Cooperative Societies Act.

[3] For Benefit: NBFC-MFIs incorporated under the *Companies Act,* 1956 and registered with RBI.

Presently microfinance sector is governed by various by-laws and there is no transparency in pricing, lending and borrowing operations of MFI. In the lack of proper regulation in the system of innovative contractual structure (Joint Liability Group) coupled with for-profit MFI has been questioned on the ground of fair practices, reasonable interest rates and appropriate collection practices. Saad and Azwer (2014) opined for market regulator which can ensure client protection, sound regulation and supervision with careful prioritization. To regulate the Rs. 28,000 crore microfinance industry in India, a parliamentary panel has rejected the bill on microfinance institutions and asked the government to bring a fresh legislation before the parliament.

In order to ensure effective monitoring of the functioning of NBFC-MFIs, their compliance with the regulations and code of conduct and in the best interest of the customers of the NBFC-MFIs, the Reserve Bank has decided to accord recognition to industry associations as SRO of NBFC-MFIs. Self-regulatory organization (SRO) is an organization that exercises some degree of regulatory authority over an industry.

Models/ Types of Microfinance: In India there are four models which are different to each other two models i.e. Self Help Group-Bank linkage (SBLP) and Microfinance Institution (MFI)/Joint Liability Group (JLG) Model, are quite famous.

- Self Help Group (SHG) Model
- Microfinance Institution (MFI)/Joint Liability Group (JLG) Model.
- Agent Intermediated Loans (AIL)
- *E*-Microfinance

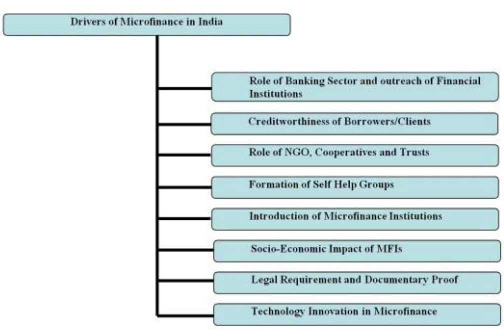
The following table below shows the different models/approaches in the field of Microfinance

	Models			
	SHGs	**MFI**	**AIL**	***E*-Microfinance**
1. Methodology	Members form groups, pools saving and lending themselves with supplementary funding by banks.	Lend to relatively small group of individuals of JLG with collective repayment obligation.	Borrowers are identified with intermediaries with whom they are in touch (traders, lenders and suppliers or gram Panchayat.	Websites publishes a list of loan seekers.
2. Financing	Refinanced by NABARD	Fund Raising from banks and financial markets	Microfinance institutions via intermediates.	Prospective lender chooses borrower of his/her choice
3.Target Group	Women in villages.	Women in villages.	Farmers and agriculturists.	NA
4. Repayment	Repayment cycle is decided by group and can be extended by banks.	Convenience with small weekly repayments corresponding to cash flows	Repayment matches with agricultural cycle. (usually for four months)	As the borrower repays the loan, the money is available in the account of lender
5.Group Size	15-20	05-08	Individuals	Individuals
6.Famous Agency/ Promoter	NABARD	Grameen Bank, SKS Microfinance, Bandhan	Agents	KIVA, Rand De, Microgram

4.2 Drivers of Microfinance in India

On the basis of available literature there are various deriving factors for microfinance in India.

Fig 1: The following chart shows various drivers of microfinance in India.



4.2.1 Role of Banking Sector and outreach of Financial Institutions

Location of bank branches in rural and far flung area is one major concern. In other words we can say the larger the network larger would be the client base. If people are provided with easy access to financial institutions where it was otherwise not possible it would be good to connect all of them to the formal financial setup and more and more account holders will be in financial umbrella. Amin *et al.* (2003) argued that microfinance programmes are more successful at reaching poor, but less successful at reaching the most vulnerable among them. Some of them even argued that disbursing credit to the poor to make financial gains out of the same cannot be the aim of microfinance institutions. Zohra & Pandey (2011) found that majority of the population in India belong to the unbanked sector, though India has a dense and a robust formal financial system, banking statistics reveals that the major section of society still remains outside the banking system and they (banking institutions) have not reached the deprived segment of the population. Thus, microfinance sector aims to improve the living of the poor income households thereby providing banking & financial services to the low income deprived population. Now in the wake of deprivation from formal financial setup, the opportunity arises for the informal system which can fill the gap by providing microfinance services to poor.

Sudesh and Sahoo (2011) examined the role of micro finance in the empowerment of people and the realization of financial inclusion (access) in India. They have the opinion that with increasing demand for rural finance, and the inadequacies of formal sources, the MFIs have immense opportunities in the new avatar of micro credit in India. However, in the light of recent experiences and the need for qualitative growth, they suggested that MFIs should be managed with better scrutiny in terms of finance and technology as well as social responsibility. This is of utmost importance in order to upgrade MFIs from thrift and credit institutions to capacity-building and livelihood-sustaining associations of people.

4.2.2 Creditworthiness of Borrowers/ Clients

Due to low income or no income, poor people believed to be unviable to formal banking system. Bank serves those people who can give some collateral against the loan. Creditworthiness can be defined as an assessment of the likelihood that a borrower will serve their debt obligations on time. It is based upon factors, such as their income level, history of repayment, if any. Wrenn (2005) highlighted the fact that because the poor do not have assets to act as collateral, banks do not entertain them. Feschijan (2008) defined creditworthiness as a presumed ability to meet agreed deadlines related to repaying the credit and the interest accrued without affecting the vitality of the borrower, i.e. the repayment process should be based on the income received in the process of the borrower's usual activity, without affecting adversely his financial situation, his financial results as well as other business entities.

Banks provide loans and charge interest on it. While financing each and every client they have to ensure that borrower will repay the principal sum and interest or both on time. The analysis of the creditworthiness involves the study of factors like income levels, financial assets etc. which can guarantee the repaying capacity of client. While Aziz & Alam (2012) found that maximum borrowing is for agricultural needs, which is highly risky engagement. If the yield is low the farmers are caught in debt trap on one hand and on other in starvation. It is difficult to pay weekly payments with such a high interest. Another reason for charging high rate of interest is high transaction cost.

4.2.3 Role of NGOs, NBFCs and Cooperatives

The Self Help Group (SHG)-Bank Linkage Program (SBLP) started in India in 1992 under the supervision of NABARD. It was transition phase for Indian economy which faced various ups and downs till then and had a difficult time. Data collected by NABARD shows that has significant impact on the livelihood of the people. Other model was MFI comprising various entities like, NBFC, Cooperatives and non-government agencies. Shastri (2009) showed that the dynamic growth of the microfinance industry has been promoted not only by market forces but also by conscious actions of national governments, Non-Governmental Organizations (NGOs), and the donors who view microfinance as an effective tool for eradicating poverty. Kundu (2011) concluded that the non-motivated NGO, who itself plays the function of the self-help group, can offer credit to the group members at lowest possible rate of interest and arrange sufficient training for the group members for skill improvement after group formation, if, and only if, it gets sufficient financial support from the government in the initial period and if the linked commercial bank charges low lending rate to the group in credit-linkage program.

4.2.4 Formation of Self Help Groups

In absence of robust banking network some organisations like elf employed women's association (SEWA) came into existence in early 1970s which started forming self help groups of 10-15 people. According to Gurumoorthy (2000), Self Help Group (SHG) is a viable alternative to achieve the objectives of rural development and to get community participation in all rural development programmes. Anjugam & Ramasamy (2007) in their study found that socially backward households and landless and marginal farm households participate more in the SHG-led microfinance programme and they suggested that higher number of self-help groups may be formed among the economically and socially disadvantaged households in order to relieve them from the clutches of moneylenders and at the same time to bring the poor under the fold of formal banking institutions. Saad & Asif (2013) concluded that microfinance is a new method to meet the credit requirement in rural areas. It is being viewed as one of the most powerful tools for uplifting the economic condition of asset-less poor through group approach that6 ensures active participation and involvement of the beneficiaries in effective implementation of the programme.

4.2.5 Introduction of Microfinance Institutions

The idea of Joint Liability Group or JLG model originated from Bangladesh and also known as Grameen Bank Model. The Grameen Bank did contrary to the traditional banking by focusing and extending loans to the poor without any collateral and helped them to escape from the impenetrable circle of "low income, low savings, low investment, and low income". Joint Liability Group (JLG) Model is also known as Microfinance Institution (MFI) Model which is a growing component in Indian economy and is characterized by inclusive banking. It was novel idea in the field of finance, where poor people who were considered non bankable were given financial assistance. Shetty & Veerashekharappa (2009) studied the importance of microfinance in bringing about financial inclusion. They said the impact of the increasing gap in demand and supply of financial services in India which has led to the increasing population of the country to be excluded from the formal financial credit system.

4.2.6 Socio-Economic Impact of Micro Finance Institutions

One of the key roles microfinance played in the recent past is access of financial services at door step of poor; and for those who were neglected by formal banking system. In other words it can be said that it has social mission where untouched section of society has to be brought under financial arena. Robinson (2001) observed that commercial microfinance is not meant for core poor or destitute but is rather aimed at economically active poor. There are several studies which appraise it on the ground that it completely changed the picture and helped vulnerable section of society by raising their income levels. In his opinion, Islam (2009) says that microfinance may play a more important role in poverty and insecurity reduction through its indirect, broader impact rather than its immediate financial impact. Most MFIs have a social mission. Luyiraka (2010) in her research found that micro-credit had played a big role in the socio-economic development of the women, because respondents used loans for very basic services like school fees for the children, to buy furniture and houses, start up business enterprises.

Moses (2011) found that the impact of microfinance programme especially through self-help groups (SHGs) has been effective in making positive social change to all members, irrespective of the direct borrowers of the micro credit. Aruna & Jyothirmayi (2011) found that microfinance has a profound influence on the economic status, decision making power, knowledge and self worthiness of women participants of self help group linkage program in Hyderabad. The microfinance related loan availement and its productive utilization found to be causing significant differences in women empowerment levels, measured through women empowerment index (WEI), of the loan availed participants as compared to the non- loan availed.

4.2.7 Legal Requirement and Documentary Proof

In formal banking sector, people asked to furnish details like identity card, salary slip (authenticated by the employer and self attested for employees), election id card, ration card, driving license etc. for their identification before availing services such as opening up of new the account or loan for business. This may be reason due to which many potential borrowers may not be considered viable and same is the irony. But in case of micro financing lenders did contrary to it started giving financial assistance without any identity and collateral.

4.2.8 Technology Innovation in Microfinance

The various agencies involve in carrying the business of microfinance have to maintain the database of borrowers, their occupation and other details, which can be shared among organisations. *E*-microfinance adopted a new approach and provides an online platform where potential borrowers and prospective lender come into contact and the lender can choose the borrower and makes monthly or quarterly payments.

5. Conclusion & Suggestions

There is one famous Chinese proverb "Give a man a fish he eats for a day, teach a man to fish he eats for a lifetime" is true for the concept of microfinance. It has proved a major breakthrough in the field of financial inclusion. From the last quarter of twentieth century, when it came into being, it seemed a magic wand and acclaimed a a viable alternative to formal financial system and proved helpful in policy objectives like poverty alleviation and financial inclusion in India. It has become a preferred option for petty traders, who need very small-sized loans and its impact on economic condition of social strata is also appreciating which is reflected on various parameters like education, employment and entrepreneurial activities.

There are four models in the field of microfinance in India namely self help group- bank linkage model (SBLP), microfinance institution or joint liability groups (MFI/JLG), agent intermediated lending (AIL) model and *E*-microfinance. Although they are serving the unbanked people but have their own lending & borrowing operations and repayment policies.

In this exploratory study various drivers have been discussed which paved the way for microfinance and affects the growth of microfinance sector in India. The key drivers of microfinance can be said found are creditworthiness of the borrowers, growing role of NGOs and the growth of self help groups, introduction of MFIs etc. which played a pivotal role in the development of microfinance in the country. Ease in the legal and the regulatory framework and use of IT increases the acceptability of microfinance.

Government should take serious steps for transparent and efficient working of the sector, where complexities can be removed and the targeted section can be benefitted at large. One such step is Microfinance regulation and development bill in Parliament and the Pradhan Mantri Jan Dhan Yojana for financial inclusion at mass level. The advent of various organizations with broad range of services such as small deposits, micro credit, loans, payment services and micro insurance proved it a successful platform which can better serve the needs of the people at bottom where formal financial system did not reach. The programme is an important conduit not only in poverty alleviation and bringing the gender equality but also helped people to establish small businesses, which will ensure India as a self-reliant and an egalitarian society.

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