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A Conceptual Analysis of Microfinance in India

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Abstract

In nations classified as developing, such as India Microfinance serves as a crucial instrument in the alleviation of poverty. This paper examines the challenges and effects of microfinance in India. It begins by defining microfinance and tracing its development, emphasizing its significance in empowering marginalized communities through improved access to financial services.
The study examines the socio-economic effects on borrowers, with particular emphasis on women and rural communities. It aims to enhance income generation, educational attainment, and overall quality of life and living standards.

In India, approximately 75 percent of the population resides in rural areas, specifically in villages, with around 70 percent of this demographic relying on agriculture-related activities such as farming, fishing, and animal husbandry, according to World Bank reports. These rural communities play a crucial role in delivering financial services to economically disadvantaged individuals, including the poor and illiterate, as well as those with low incomes.

Micro-finance performs work related with the financial services including deposits, loans, payment services, money transfers, insurance, savings, and microcredit for the impoverished. Micro-finance plays a vital role in the developing economies of India where a large population is living under poverty line and large number of people does not have an access to any banking facilities like internet banking, m banking, etc.
In conclusion, this paper highlights the significant transformative potential of microfinance in promoting inclusive growth and advancing sustainable development objectives in India. Through a thorough overview and analysis, it adds to the ongoing dialogue regarding the optimization of microfinance initiatives to enhance their socio-economic impact.

The primary objective of this paper is to assess the current status and role of microfinance in shaping the future development of India.

KEYWORDS: Microfinance, credit facility, Growth of Microfinance institutions, Poverty

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INTRODUCTION

Microfinance serves as an effective instrument for socio-economic advancement in developing nations. . It is not a new concept, it's an old concept. It relates with the early 18th century when money lenders have served as informal financial institutions. In response to the challenges of poverty in developing countries, policymakers, international development agencies, non-governmental organizations, and other stakeholders have implemented various development strategies. Among these, a particularly notable approach that gained significant traction in the early 1990s is the microfinance scheme. This initiative aims to provide financial services, including savings and credit opportunities, to economically disadvantaged working individuals.

According to the World Bank, India belongs to the country having more than 80 percent of low income class people. It is the most populated country in the world. Around three forth of its population lives in rural area, where people depend only on agriculture; as a result, rate of unemployment is high. Rural people have no knowledge about credit facility. So, various initiatives steps have been taken by Indian government to educate these people. That's why Micro-finance is a effective tool for poverty reduction and socio-economic development of our country. Hence Micro-finance can play an important and crucial role in improving the standard of living of poor people.

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The inception of the micro-finance movement in India can be traced back to the Self Help Group (SHG) – Bank Linkage Programme (SBLP), which was initiated as a pilot project in 1992 by the National Bank for Agriculture and Rural Development (NABARD). This program has demonstrated significant success and has evolved into a widely accepted model of micro-finance within the country. Micro-finance services are offered by various entities, including commercial banks such as Regional Rural Banks (RRBs), SHGs, cooperative societies, and Microfinance Institutions (MFIs), which encompass non-governmental organizations (NGOs) and Non-Bank Financial Institutions (NBFIs). The regulatory framework for banks and NBFIs is overseen by the Reserve Bank of India (RBI), while SHGs are regulated by NABARD, and cooperatives fall under the jurisdiction of the Registrar of Cooperative Societies (RCS), among other authorities.

LITERATURE REVIEW

The study conducted by Kumar Vipin et al. (2019) concluded that Self-Help Groups (SHGs) and Microfinance Institutions (MFIs) play a vital role in providing microfinance services that contribute to the development of impoverished and low-income individuals in India. Nonetheless, various research findings across different regions of the country have also highlighted challenges such as the slow progression of SHG members towards graduation, suboptimal group functioning, and the dropout of members from these groups.

Maruthi Ram Prasad, Sunitha, and Laxmi Sunitha (2011) conducted a study examining the impact of microfinance within the Indian context. Following initial efforts by the government, banks, and non-governmental organizations, the microfinance sector in India has reached a pivotal stage of development. The study suggests that initiatives should be undertaken to cultivate a new generation of micro-credit leaders, thereby enhancing the establishment of Micro-Finance Institutions (MFIs) and maximizing their contributions to sector growth and poverty alleviation. By harnessing the entrepreneurial potential of economically disadvantaged individuals, India can undergo transformative changes that are currently only beginning to be envisioned.

Idowu Friday Christopher (2014) carried out a study to evaluate the impact of microfinance on small and medium-sized enterprises (SMEs). The primary objective of this research was to assess how microfinance affects SMEs. A simple random sampling technique was utilized to select a sample of 100 SMEs for the study. A structured questionnaire was developed to gather pertinent data for analysis. Descriptive statistics, including simple percentages and graphical representations, were employed for data presentation and analysis. The findings indicate that a significant number of SMEs benefited from loans provided by MFIs, although only a limited number were able to secure the full amount required. Notably, the majority of SMEs recognized the positive impact of MFI loans on enhancing their market presence, fostering product innovation, achieving market excellence, and gaining a competitive advantage in the overall economic landscape. In addition to tax incentives and financial support, it is recommended that the government provide adequate infrastructural facilities, such as reliable electricity, improved road networks, and training institutions, to further support the growth of SMEs.

SIGNIFICANCE OF THE STUDY

In India, there currently exists no effective model for analyzing the financial performance and sustainability of microfinance institutions (MFIs). This issue is exacerbated by the absence of dedicated legislation governing the operations and management of these institutions. Furthermore, the lack of a regulatory framework for financial disclosures by MFIs contributes to the problem. The present study aims to examine the significance of microfinance and to evaluate the performance of MFIs operating within India. This research is particularly important as it is crucial for these institutions to operate efficiently, given that they utilize limited and marginal capital, with the intended beneficiaries being the underprivileged segments of society. It is essential for MFIs to achieve financial sustainability in order to effectively pursue their objectives and enhance the economic conditions of their target populations.

METHODOLOGY AND DATA

The research design employed in this study is both descriptive and exploratory in nature. The data utilized for this analysis was gathered from a variety of sources. In order to evaluate the performance of microfinance institutions in India, pertinent information regarding outstanding loans, loans disbursed, client outreach, assets, and other relevant metrics was obtained from the "Status of Micro Finance in India," NABARD reports (various editions), The Bharat Microfinance Report (various editions), and additional relevant sources covering the period from 2018-19 to 2019-20. Basic statistical tools, such as averages and percentages, were applied to analyze the data.

STUDY OBJECTIVES

1. To recognize and understand the concept of microfinance within the Indian context.
2. To analyze various models and prospective developments of microfinance specifically for urban regions.
3. To investigate the role, effectiveness, and significance of microfinance in India.
4. To assess the present condition of microfinance institutions operating in India.

Concept of Microfinance

Microfinance serves as a vital mechanism for empowering impoverished and marginalized individuals within society who lack access to formal banking services. It facilitates the accumulation of assets, diversification of livelihood opportunities, enhancement of income, and mitigation of economic vulnerability. Historical evidence suggests that the provision of financial products and services to low-income populations by Microfinance Institutions (MFIs) can be both feasible and sustainable, as these institutions are capable of covering their operational costs through appropriate interest margins

It is important to note that microfinance is not a panacea that guarantees the eradication of poverty for all its clients. However, numerous impact assessments have indicated that microfinance does provide tangible benefits to low-income households (Littlefield and Rosenberg, 2004). The Asian Development Bank (2000) characterizes microfinance as the delivery of a comprehensive array of services, including savings, deposits, loans, payment services, money transfers, and insurance, to impoverished and low-income households, as well as their micro-enterprises. This definition encompasses not only those living below the poverty line but also extends to low-income households. Furthermore, the task force on Supportive Policy and Regulatory Framework for Microfinance, established by NABARD, defines microfinance as "the provision of thrift, savings, credit, and financial services and products of very small amounts to the poor in rural, semi- urban, and urban areas, aimed at enabling them to enhance their income levels and improve their standard of living."

(Sen, 2008). Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses (Robinson, 1998). In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self confidence and the training of members in that group on financial literacy and management (Ledgerwood, 1999). There are different providers of microfinance (MF) services and some of them are; Non Governmental Organizations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non banking financial institutions. The target group of MFIs are self employed low income entrepreneurs who are; traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers, artisans blacksmith etc (Ledgerwood, 1999).

Characteristics of Microfinance:

- Microfinance plays a significant role in the realm of rural finance.
- It offers small-scale loan facilities tailored to limited budgets.
- It is recognized as one of the most effective strategies for poverty alleviation.
- Microfinance promotes women's participation in economic activities.
- It provides incentives for individuals to pursue self-employment opportunities.

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- The focus of microfinance is primarily service-oriented rather than profit-driven.
- It is designed to support small entrepreneurs and producers in their endeavors.

Microfinance encompasses a broad spectrum of services, ranging from microcredit to macrocredit. Microcredit specifically refers to the provision of credit services to economically disadvantaged clients. It is important to distinguish between microcredit and microfinance, as they are not synonymous. Microcredit pertains to small loan amounts extended by banks or legally registered institutions, while microfinance encompasses a variety of services, including loans, savings, insurance, remittance services, and microcredit loans, aimed at supporting both urban and impoverished populations.

Evolution of Micro Finance

The development of the microfinance sector in India can be categorized into four distinct phases:

Phase1:The Cooperative Movement (1900-1960)
In this initial phase, credit cooperatives served as mechanisms for providing subsidized credit to rural areas, facilitated by government support.

Phase 2: Subsidized Social Banking (1960s - 1990)
With failure of cooperatives, the government focused on measures such as nationalization of Banks, expansion of rural branch networks, establishment of Regional Rural Banks (RRBs) and the setting up of apex institutions such as the National Bank for Agriculture and Rural Development (NABARD) and the Small Scale Industries Development Bank of India (SIDBI), including initiation of a government sponsored Integrated Rural Development Programme (IRDP).

Phase 3: SHG-Bank Linkage Program and the Development of NGO-Microfinance Institutions (1990 - 2000)
The inadequacies of subsidized social banking prompted a significant transformation in the provision of rural credit, with NABARD launching the Self Help Group (SHG) Bank Linkage Programme (SBLP). This initiative aimed to connect informal women's groups with formal banking institutions, thereby enhancing the outreach of the banking system to previously underserved populations and fostering a shift in the perception of low-income families from 'beneficiaries' to 'customers.' Consequently, this era was characterized by the provision of credit at market rates. The model garnered considerable interest from newly established Microfinance Institutions (MFIs), primarily of a non-profit nature, seeking to collaborate with NABARD under this initiative. The macroeconomic crisis of the early 1990s, which precipitated the Economic Reforms of 1991, granted greater autonomy to the financial sector and facilitated the emergence of new generation private sector banks, which would become significant contributors to the microfinance landscape.

Phase 4: Commercialization of Microfinance
The First Decade of the New Millennium Following the reforms, rural markets emerged as pivotal growth drivers for MFIs and banks, with the latter showing interest in the sector not only as a facet of their corporate social responsibility but also as a viable business opportunity. On the demand side, NGO-MFIs increasingly transitioned into more regulated legal entities, such as Non-Banking Finance Companies (NBFCs), to attract commercial investments. The contemporary microfinance sector is predominantly characterized by two primary delivery models: the SBLP and MFIs. Notably, four out of five microfinance clients in India are women.

DATA ANALYSIS AND DISCUSSION

Year	2015-16		2016-17		2017-18		2018-19		2019-2020	
Particular	No. of MFIs	Amt.	No. of MFIs	Amt.	No. of MFIs	Amt.	No. of MFIs	Amt.	No. of MFIs	Amt.
Loan Disbursed by Banks/FI to	426	7840	545	10282	589	15190	647	20796	2314	19304

MFIs	(-8.4)	(50.6)	(28.0)	(31.2)	(8.1)	(47.7)	(9.8)	(36.9)	(257.6)	(-7.2)
Loan O/S against MFIs on 31st March	2042 (4.2)	14426 (26.0)	2422 (18.6)	16517 (14.5)	4662 (42.5)	22500 (36.2)	2020 (56.7)	25581 (13.7)	5357 (165.2)	29225 (14.3)
Fresh Loans as % to loans O/S		54.3		62.3		148.13		123.0		151.4

Table presented progress under MFI-Bank linkages programme.

Table : Rural and Urban Share of MFI Borrowers

Year	Rural	Urban	Total
2015-16	184 (67)	91 (33)	275 (100)
2016-17	185 (56)	145 (44)	330 (100)
2017-18	122 (33)	249 (67)	371 (100)
2018-19	152 (38)	247 (62)	399 (100)
2019-2020	180 (61)	115 (39)	295 (100)

Table presented Rural and Urban Share of Borrowers

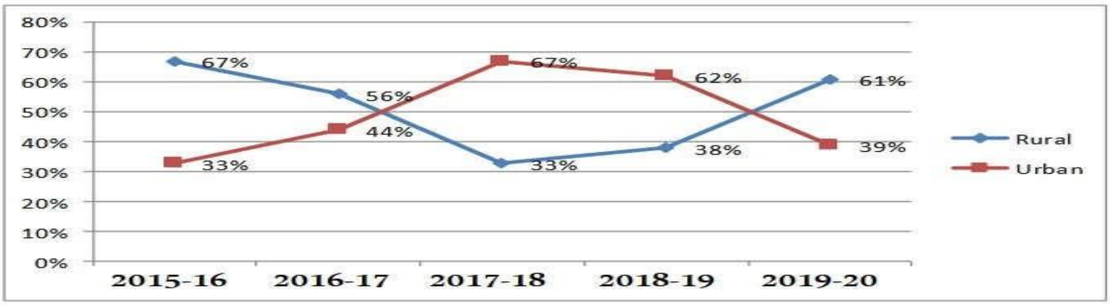

Table : Income generation loans and non-income generation loans(in Crore)

Year	Income generation loan	Non-Income generation loan	Total
2015-16	23474.36 (91)	2321.64 (9)	25796 (100)
2016-17	30846.4 (80)	771.6 (20)	38558 (100)

2017-18	47129.6 (80)	11782.4 (20)	58912 (100)
2018-19	68004.3 (94)	4340.7 (6)	72345 (100)
2019-2020	44579.95 (85)	7867.05 (15)	52447 (100)

Table shows Income Generation Loan and Non Income Generation Loans

FINDINGS

- The number of Microfinance Institutions (MFIs) obtaining loans from banks during the fiscal year 2019-20 experienced a significant increase of 28% compared to the previous year, 2018-19. Notably, there was a continuous rise in the number of MFIs accessing bank loans, with the growth rate escalating from 9.8% to 257.6% between 2018-19 and 2019-20.

- The total volume of loans extended to MFIs by banks demonstrated an upward trend during the years 2017-18, 2018-19, and 2019-20, with increases of approximately 50.6%, 31.2%, and 47.7%, respectively. However, there was a decline of 7.2% in total loans to MFIs in 2019-20 compared to the preceding year.

- The outstanding loan amounts against MFIs showed consistent growth in subsequent years, with increases of 13.7% and 14.3% in 2018-19 and 2019-20, respectively. Additionally, the ratio of new loans to outstanding loans has risen in each subsequent year.

- The proportion of rural clientele among MFIs was recorded at 67% in 2016, which decreased to 56% in 2017 and further declined to 33% in 2018. In 2019, there was a slight recovery, with the rural client share increasing to 38%. The trend observed in 2017, which indicated a shift from rural to urban clientele, was influenced by the exclusion of six Small Finance Banks (SFBs). A significant finding of this study is that smaller MFIs tend to be more focused on rural markets.

- The proportion of income-generating loans remained stable in 2018, but surged to 94% in 2019. By 2020, the ratio of income-generating loans to non-income-generating loans was reported at 85:15.

- The total assets held by MFIs rose from Rs. 22,736 crore in 2014 to Rs. 58,621 crore in 2019, reflecting a consistent growth trend over the six-year period. However, in 2019-20, there was a notable decline of 21% in total assets.

CONCLUSION

In conclusion, the significance of microfinance in developing countries, such as India, cannot be overstated, as it plays a crucial role in enhancing the socio-economic conditions of impoverished and low-income populations. Since the 1990s, poverty alleviation has been prioritized at both national and international levels of development. Within this context, various initiatives have been implemented by the government, with microfinance emerging as an effective strategy for poverty reduction and socio-economic advancement.

Microfinance has the potential to significantly improve the living standards of economically disadvantaged individuals. The economic development of any nation is profoundly affected by the accessibility of financial services. Microfinance encompasses a wide array of financial services, including deposits, loans, payment services, money transfers, insurance, savings, and micro-credit, specifically tailored for low-income individuals. A robust financial system fosters investment opportunities within an economy.

Consequently, it is imperative for the Government of India to prioritize the expansion of financial services in both rural and urban areas to ensure sustainable and inclusive growth. Over the past two decades, microfinance institutions in India

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have played a vital role in rural development. The central government and the Reserve Bank of India (RBI) should implement necessary measures to sustain the growth of the microfinance sector. Additionally, state governments must take proactive steps to raise awareness among the populace regarding the benefits of utilizing microfinance services to enhance their livelihoods and economic status.

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