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Microfinance in India: A comprehensive overview

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Abstract

Microfinance in India has become an important way to fight poverty and improve access to financial services, especially for people in rural, semi-urban, and urban areas who are economically disadvantaged. This study focusses on the current status of Microfinance in India. Microfinance institutions (MFIs) provide small loans, savings, and insurance, focusing mainly on giving small loans to those who need them most. Initially, the government, through programs like NABARD's Self-Help Group Bank Linkage Program (SBLP), played a big role in promoting microfinance. Over time, private organizations also started participating. The Reserve Bank of India (RBI) regulate these institutions to ensure they operate transparently and sustainably.

Keywords: Microfinance, credit bureau, banking

Introduction

Poverty is one of the persistent problems prevalent in the developing and underdeveloped countries of the world. Most of the developing and underdeveloped countries have recently been pursuing various policies and programs to eradicate poverty for sustainable economic development. Among these policies one of the most important and effective ones is microfinance. Muhammad Yunus, the father of microfinance, popularized the concept of microcredit as sustainable development for improvement. Microcredit, being part of financial inclusion, is defined as the provision of thrift, credit, and other financial services and products of minimal amount to the poor in rural, semi-urban, and urban areas to enable them to raise their income levels and improve their living standards (RBI Master Circular, 2010) [5]. Microfinance is growing in India on the ground of social entrepreneurship.

Microfinance is seen as an important tool for poverty alleviation and over the years, microfinance institutions (MFIs) have placed themselves as fulfilling this developmental goal. The microfinance sector started evolving with private sector participation leading to the formation of microfinance institutions (MFIs). The MFIs accessed bulk funds from banks and did on-lending to the end borrowers [either SHG members or Joint Liability Group (JLG) members]. From there on the microfinance activities were implemented by the two channels including the MFI model and the SHG bank linkage model.

The microfinance movement was initiated by NABARD in 1992 in collaboration with Banks and Non-Government Organizations (NGOs) for the unbanked population through an initiative known as the Self-Help Group Bank Linkage Program (SBLP). The program was a government-initiated program with refinancing to banks from NABARD. SBLP involved NGOs to form Self Help Groups (SHGs) and train them. Each SHG typically consists of a group of women/men members interested in accessing financial services including savings, credit insurance, etc. Post the training, NGOs provided SHGs access to funds by linking them to banks that provided financial services (including thrift, credit, etc) to them directly. NGOs' role was to ensure the financial discipline of the SHGs. Apart from this, there were state government-run SHG programs. Thus, microfinance in this phase was government-driven.

The sector witnessed a high growth rate during the period from 2006 to 2010 supported by funding availability and potential demand in the sector. The growth was mainly driven by the MFIs due to the large-scale availability of funding in terms of both debt and equity. The overall loan portfolio increased from 2007 to 2015 which included growth from SBLP and MFI model. However, the focus of the microfinance sector is mainly on micro-credit with other products still evolving including thrift, insurance, and remittance. Micro Financing has been initiated in all the countries having poverty-stricken people. Micro Financing serves not only the goal of poverty reduction but also other two-millennium development goals such as, women's empowerment and increase the literacy rate among women.

India, the world's third-largest economy by purchasing power, has significant untapped potential due to the exclusion of around half a billion people from the formal financial sector. Despite a setback in 2010 when the state of Andhra Pradesh banned local microfinance operations, the sector has rebounded strongly. Now, the sector is governed by the Reserve Bank of India and benefiting from improved transparency through credit bureaus. The microfinance sector serves 30 million clients and grows at a sustainable rate of 30% to 50% annually. Established MFIs have adapted to legal regulations, expanding their client base and increasing operational efficiency. This growth is higher than the region's average and gained the fastest rate of expansion since 2009, and will be useful for further development of India's vast market of vulnerable households.

Microfinancing has become increasingly important recently, especially because it mainly involves women. People see that involving women in development can lead to lasting growth. Women often face poverty because they use their earnings to support their families. This is the reason for governments and other organizations' attention to microfinance. They believe it is a good way to reach out to women and help them become more empowered. The microfinance initiative in the private sector in India can be traced back to an initiative undertaken by Swashrayi Mahila Sewa Sahakari Bank or Self-Employed Women's Association Bank (SEWA Bank), which is the only co-operative bank in India of its kind, operated and maintained by self-employed women, it is providing banking services to the poor women employed in the unorganized sector in Ahmedabad in Gujarat. This Bank was established at the initiative of 4000 self-employed women workers who have successfully reached the 92 percent loan repayment rate which is highest among all the financial intermediaries in India.

MFIs in India have non-profit motivation on the one hand and profit maximization for long-term viability for credit disbursement on the other hand. Microfinance institutions in India can be broadly classified into five categories: (1) NGO MFIs (registered under the Societies registration Act 1860), (2) Public trusts, Non-profit companies, (3) Co-operative MFIs (registered under the State Cooperative Societies Act), (4) Non-banking finance companies (NBFCs) MFIs (incorporated under the Companies Act 1956) and (5) Local area banks (the only such MFI is Krishna Bhima Samruddhi Local area banks).

Microcredit has not been the main focus of the Indian financial sector yet. But India now changed focus with good knowledge, money, and technology to tackle this issue. As the economy grows and conditions improve, the next few years should bring exciting developments in providing financial services to the poor in India. Microcredit will keep growing as a key way to help the poor and empower women financially. People living in poverty in rural areas, particularly in developing countries, face a significant need for credit. Therefore, microfinance programs should provide access to these credit opportunities and encourage individuals to improve their standard of living (Yadav, 2014) [6].

Key characteristics of the microfinance business environment

The current focus of the microfinance sector is mainly on micro-credit with other products still evolving including thrift, insurance, and remittance. However, the potential demand for the microfinance sector is huge only 35 percent of adults have formal accounts and 8 percent have borrowed from a formal financial institution (including microfinance institutions) in India. It further states that this 8 percent coverage in India is higher than the other BRIC economies (7 percent) and one of the factors responsible is the relatively well-developed microfinance industry in India. Going forward, MFIs are likely to expand their client base and reach out to more underserved areas of the country. (Demirguc-Kunt *et al.*, 2013) [3].

The Reserve Bank of India regulates two types of institutions that engage in microfinance activities: banks and non-bank financial companies (NBFC)-MFIs. Following the crisis in Andhra Pradesh (AP) in 2011, the RBI put in place regulatory changes that helped reassure market participants and noted rapid growth in total loans in 2012 and subsequent years. The RBI recognizes that its role is not only to regulate but also to develop microfinance and the political support of microfinance by the national government.

The financing of Indian microfinance is dominated by commercial debt. MFIs have been paying for this heavy reliance on commercial bank funds. Instead, total loan growth has been around 30 percent and there has been an equal rise in the equity flows funding NBFC MFIs. There has been a shift from a focus on quantity (rapid loan growth) to quality (more sustainable loan growth). Credit bureaus have started to make a difference in spotting clients with multiple loans. However, they still constitute an imperfect tool to deal with the problem of over-indebtedness, because of the many informal sources of finance that are not covered by the credit bureaus.

The regulatory framework provides for a dispute resolution system in the microfinance industry. There has been a vast improvement in client protection following the AP crisis and new regulations that resulted from the crisis. There is increasing evidence of the flow of bank funding returning to the microfinance industry (particularly outside AP). There has been a surge in equity funding and the portfolio at risk is below 1 percent. The new 40 percent priority sector guidelines for foreign banks with over 20 branches are expected to increase bank funding to MFIs over the near to medium term. Following an RBI announcement in February 2013, large NBFCs are now allowed to submit applications for banking licenses.

Key highlights of the Indian microfinance industry

As of 31st March 2015, MFIs provided microcredit to over 30.50 million clients, an increase of 29 percent over FY 13-14. The aggregate gross loan portfolio (GLP) of MFIs stood at Rs 401.38 billion [excluding non-performing (PAR > 180 days) portfolio (Rs 26 billion) and SKS portfolio (Rs 0.13 billion) in Andhra Pradesh]. This represents a YOY growth of 61 percent over FY 13-14. Annual disbursements (loan amount) in FY 14-15 increased by 55 percent compared to FY 13-14. The total number of loans disbursed by MFIs grew by 37 percent in FY 14-15 compared with FY 13-14 reaching 33.43 million. Funding to MFIs in FY 14-15 grew by 84 percent compared with FY 13-14. Portfolio at Risk (PAR) figures (PAR 30, 90, 180) remained under 1 percent for FY 14-15. The average loan amount disbursed per account is now Rs 16,327. MFIs now cover 32 states/union territories (489 districts). MFIs' coverage is now geographically well dispersed with GLP in the south at 30 percent, east at 28 percent, north at 22 percent and west at 20 percent. Productivity ratios for MFIs continued to improve. GLP per branch is now at Rs 38.03 million, up by

49 percent over FY 13-14. Insurance (credit life) to over 36.36 million clients with a sum insured of Rs 670.50 billion was extended through the MFI network. Pension accounts were extended to over 1.87 million clients through the MFI network.

Table 1: Trends in the Microfinance industry of India

Indicator	FY	09-10	10-11	11-12	12-13	13-14	14-15
Branches	Number	8697	11249	9,380	8,848	9,741	10,553
	YOY change (%)	-	29	-16.61	-6	10	8
Employees	Number	74,608	92,221	68,252	59,240	66,959	80,097
	YOY change (%)	-	24	-25.99	-13	13	20
Clients	Million	22.57	27.69	20.66	19.42	23.68	30.50
	YOY change (%)	-	23	-25.39	-6	22	29
GLP (Gross Loan Portfolio)	Rs Billion	175.03	200	168.13	174.07	248.62	401.38
	YOY change (%)	-	14	-15.94	4	43	61
Loans disbursed	Million	17.49	15.84	17.43	18.32	24.46	33.43
	YOY change (%)	-	-9	10.04	5	33	37
Loan amount disbursed	Rs Billion	-	324.18	207.41	233.75	351.18	545.91
	YOY change (%)	-	-	-36.20	13	50	55
Lives insured	Million	-	-	-	19.7	31.0	36.4
Sum insured	Rs Billion	-	-	-	292.98	501.45	670.50

Source: Micrometer, MFIN 2015 [4]

The share of SBLP in incremental loans has dropped from 64.96 percent to 40.96 percent and in actual terms is lower in 2010 than in 2008. The reasons for the increasing dominance of the MFI group vis-à-vis SBLP are, among other things: - (i) MFIs are said to be more aggressive; (ii) SHGs have longer repayment periods and during that period if SHG members need loans, they approach MFIs; (iii) Banks use MFIs to meet priority sector targets. It is believed that banks find it easier to use MFIs to meet their priority sector targets.

India's Leading MFIs

In India, maximum MFIs are present in MP and Maharashtra 27 in each state, and minimum in Arunachal, D & N Haveli, J & K, Manipur, Mizoram, and Nagaland 1 in each mentioned state (Micrometer, MFIN 2015). As shown in the table 2 Bandhan was leading MFI in terms of Gross Loan Portfolio followed by SKS, Janalakshmi, Ujjivan and Equitas.

Table 2: Top Ten MFIs of India

Sr. No.	Name of MFI	Gross Loan Portfolio (Rs. bn)
1	Bandhan	95.30
2	SKS*	41.71
3	Janalakshmi	37.74
4	Ujjivan	32.74
5	Equitas	21.44
6	Satin	21.41
7	Annapurna	15.03
8	GFSPL	14.47
9	Spandana	11.73
10	ESAF	10.16

(Source: Micrometer, MFIN 2015) [4]

The table 2 presents top ten microfinance institutions (MFIs) based on their Gross Loan Portfolio (GLP) in billion rupees. Bandhan is leading MFI with GLP of Rs. 95.30 billion. Following closely behind are SKS and Janalakshmi with GLPs of Rs. 41.71 billion and Rs. 37.74 billion, respectively. Ujjivan and Equitas occupy the fourth and fifth positions with GLPs of Rs. 32.74 billion and Rs. 21.44 billion, respectively. Satin, Annapurna, GFSPL, Spandana, and ESAF complete the list with GLPs ranging from Rs. 21.41 billion to Rs. 10.16 billion.

Microfinance Institutions present in Gujarat

Gujarat has been considered as a huge potential market in terms of microfinance. Penetration of microfinance is in a few districts in Gujarat namely Banaskantha, Sabarkantha, Mehsana, Ahmedabad, Kheda, Anand, Panchmahal, Dahod, Vadodara, Surat, Rajkot and Junagadh. The maximum numbers of potential SHGs are found in Panchmahal, Banaskantha and Sabarkantha. There are 19 MFIs are operating in Gujarat.

Table 3: MFIs in Gujarat

1	Adhikar	2	Asirvad	3	Asmitha
4	Bandhan	5	Disha	6	Equitas
7	FFSL	8	Janalakshmi	9	L & T Finance
10	M Power	11	Muthoot	12	Namra
13	Pahal	14	Sahayog	15	Share
16	SKS	17	Spandana	18	Suryoday
19	Ujjivan				

(Source: Micrometer, MFIN 2015) [4]

The table 3 indicates various microfinance institutions (MFIs) including Adhikar, Asirvad, Asmitha, Bandhan, Equitas, and Janalakshmi and others present in Gujarat.

The microfinance institutions (development and regulation) bill, 2012

Following the AP ordinance in October 2010, regulatory uncertainty surrounded microfinance activities by MFIs. In response, the Indian Government introduced the Microfinance Bill to streamline regulation and avoid multiple regulatory frameworks. Currently, with Parliament, the bill aims to address concerns and bring stability to the sector. Indian microfinance is gradually recovering due to an improved regulatory environment and governance. The Microfinance Bill, 2012, introduced in Lok Sabha in May 2012, had been pending since 2007. The Standing Committee on Finance recently presented its Eighty-fourth

Report on the Bill in February 2014. The Committee extensively discussed the draft report and heard views from various stakeholders, including MFIs, RBI, NABARD, and experts, aiming to regulate and develop the microfinance sector.

The Microfinance Bill aims to regulate MFIs offering microfinance services including credit, thrift, pension, insurance, and remittance. It establishes Micro Finance Development Councils, State Micro Finance Councils, and District Micro Finance Committees. The RBI will set maximum interest rates and oversee fair recovery practices. Registration with the RBI is mandatory for MFIs. Existing NBFCs can continue without registration. MFIs must seek RBI approval for closures or restructuring. The RBI acknowledges MFIs' continued role in financial inclusion due to incomplete bank penetration. NABARD suggests enhancing SHGs and Business Correspondence (BC) synergy. The Bill mandates RBI to establish a grievance redressal mechanism for MFI beneficiaries, potentially utilizing existing schemes for bank clients.

RBI Direction to NBFC-MFIs

RBI not only regulates but also fosters the development of microfinance, supported by the national government. Most microfinance institutions in India fall under RBI's regulation. The initiatives, driven by technology, aim at cost-effective financial services. Major efforts include promoting SHG-Bank Linkage, mandating core banking for banks, liberalizing BC service delivery, and easing KYC requirements. Domestic banks can freely expand to underserved areas, with a focus on rural centers. BC service delivery model was progressively liberalized, allowing domestic scheduled commercial banks to open branches in tier 2 to tier 6 centers. Banks were mandated to allocate 25% of new branches to unbanked rural areas, enhancing financial access and inclusion. MFIN members, registered with RBI, operate within its regulatory framework. Pricing for banks is deregulated, with interest rates on advances freed. Urban financial inclusion programs are separately initiated. These measures collectively bolster the microfinance sector's growth and accessibility in India.

85% of all the money that microfinance institutions (MFIs) have is in the form of "Qualifying Assets." These are loans that meet certain rules. For example, they are given to people who don't earn more than Rs. 1,00,000 per year in rural areas or Rs. 1,60,000 in urban areas. The loan amount cannot be more than Rs. 60,000 for the first cycle and Rs. 1,00,000 for later cycles. The total money owed by the borrower cannot be more than Rs. 1,00,000. Education and medical expenses are not counted in this total. The loan has to be for at least 24 months if it's more than Rs. 15,000, and borrowers can pay it back early without extra charges. The loan doesn't need any collateral. At least half of all the loans given by MFIs should be for making money, like starting a business, while the rest can be for things like house repairs or emergencies. Borrowers can choose to repay the loan every week, every two weeks, or every month. The interest rate on the loan should not be higher than what the MFI pays to borrow money, plus a little extra, as long as it's within the set limit. Some individual loans might have higher interest rates, but they can't be more than 26% or have a big difference between the lowest and highest rates. Small MFIs can charge up to 12% extra, while larger ones can only charge up to 10%.

In pricing loans, only three elements are allowed: processing fees (up to 1% of the loan amount), interest charges, and insurance premiums. No penalties are permitted for late payments, and no security deposit is required. MFIs must hold capital equal to 15% of their total risk-weighted assets. They must set aside provisions for overdue loan installments: 50% for those overdue for 90 to 180 days and 100% for those overdue for 180 days or more. MFIs must adhere to RBI's fair practice code and be members of Credit Information Bureaus (CIBs).

Role of Credit Bureaus in MFIs sustainability

The Reserve Bank of India (RBI) has become the primary regulator for non-banking financial companies-MFIs (NBFC-MFIs), covering 90% of the MFI sector. RBI's guidelines have led to the establishment of credit information bureaus (CIB) like Equifax and CRIF High Mark, along with Self-Regulatory Organizations (SROs) such as Microfinance Institutions Network (MFIN) and Sa-Dhan. NBFC-MFIs are required to be members of at least one CIB and one SRO to ensure credit checks and adherence to processes. Except for Andhra Pradesh, most states accept RBI's regulatory role for NBFC-MFIs, foregoing the invocation of the Money Lenders Act. The pending Microfinance Bill 2012 in Parliament may prevent future crises like the one in AP.

CIBs maintain millions of accounts with loan histories, periodically updated by MFIN members. These records include customer details and loan information, updated weekly or fortnightly for members. Borrower credit reports, available upon request, help MFIs assess borrowers' creditworthiness. MFIN mandates its members to be part of both Equifax and High Mark. The improved data quality and search algorithms have increased the strike rate, measuring the efficiency of data quality and search algorithms. Over the years, the strike rate has improved from 70% to 95%.

Since the implementation of RBI guidelines, all MFIs report to MFI-specific credit bureaus, checking every loan application against the borrower's indebtedness. RBI sets thresholds for borrower indebtedness and mandates that borrowers cannot have more than two NBFC-MFI loans simultaneously. MFIs also cannot lend to a single borrower as an individual and group borrower simultaneously, ensuring low chances of over-indebtedness. However, informal and formal borrowings from banks are not captured. MFIN's Code of Conduct mandates member MFIs to share qualitative credit information and inform MFIN of incidents of high default. All member MFIs cooperate in recovery drives and restrain lending in defaulting areas until resolved. Microfinance credit bureaus aggregate data from member MFIs, generating client reports using industry-specific search algorithms. Phonetic name matching ensures accuracy despite spelling variations. The credit bureaus have facilitated over 100 million client records, improving lending decisions.

In case of erroneous or delayed data submission, an MFI may become a third lender to a borrower. Reporting such instances to MFIN is mandatory, or complaints can be filed against the MFI. If a borrower settles a loan but it's still reported as outstanding, a No Objection Certificate from the concerned MFI is required. The Credit Bureaus have played a crucial role in portfolio quality improvement, reducing portfolio at risk (PAR30) from 2% to 0.4%.

Most MFIs submit data to operational credit bureaus like High Mark and Equifax, with some also submitting to Experian. RBI mandates credit checks through at least one credit bureau before loan sanctioning, a requirement enforced by MFIN. Microfinance credit bureaus became operational within two years, quicker than mainstream bureaus. Their presence has reduced delays and defaults, as customers are aware of the impact of bad credit history on future loan access. Defaulters were prompted to settle old dues due to refusal of new loans. In conclusion, RBI's regulations have shaped the microfinance sector, ensuring responsible lending practices and borrower protection. The establishment of credit bureaus and SROs has enhanced transparency and accountability, leading to improved portfolio quality and reduced defaults. The timely sharing of qualitative credit information among MFIs has facilitated effective risk management and recovery efforts, fostering the growth and stability of the microfinance sector in India.

Women empowerment

Microfinance institutions (MFIs) have two distinctive characteristics: a demographic focus on women and an institutional goal of empowerment. Women have been the primary clientele of MFIs since the 1970s, driven by international forces and initiatives promoting women's economic empowerment. MFIs like Grameen Bank and ACCION emerged in the 1980s and 1990s, emphasizing targeting women for higher repayment rates.

The Millennium Development Goals (MDGs) and Microcredit Summit Campaign reinforced the importance of empowering women through microfinance. Empowerment encompasses economic, educational, and decision-making aspects, aiming to increase autonomy and self-confidence. MFIs aim to provide financial services while empowering borrowers socially, culturally, and politically. The success of microfinance lies in women gaining control over resources, lifting themselves out of poverty, and achieving economic and political empowerment. Empowerment can occur at both individual and collective levels, affecting personal agency and societal norms. Micro finance program does not explain the strong form of Women empowerment rather it is weak form of women empowerment (Basu, 2006) [2]. It encompasses multiple dimensions, including economic, socio-cultural, familial, legal, political, and psychological aspects. Critics argue that the instrumental approach to empowerment overlooks broader social and economic issues. While microfinance can enhance economic independence and bargaining power for women, its impact on decision-making, self-confidence, and community involvement is difficult to measure precisely. Women's entrepreneurship is seen as a pathway to empowerment, increasing participation in decision-making and access to information. However, limited access to financial services restricts women to low-return activities, necessitating innovative collateral and simplified loan procedures. Microfinance plays a crucial role in empowering women economically and socially. By providing access to financial resources and fostering entrepreneurship, MFIs contribute to women's autonomy, self-esteem, and societal participation. However, challenges persist in ensuring equitable access to financial services and addressing broader gender inequalities. It is expected that the NGO should come up with more training sessions in income generating activities for women empowerment (Arora & Arora, 2012) [1].

Conclusion

Microfinance in India has emerged as a key tool for poverty alleviation and financial inclusion, primarily targeting the economically disadvantaged in rural, semi-urban, and urban areas. Initially driven by government initiatives like NABARD's Self-Help Group Bank Linkage Program (SBLP), the sector has expanded with significant private sector participation. Microfinance institutions (MFIs) offer credit, savings, and insurance products, with a focus on micro-credit. Regulatory oversight by the Reserve Bank of India (RBI) has enhanced sector transparency and sustainability, particularly after the 2010 Andhra Pradesh crisis. India's microfinance sector has grown robustly, serving over 30 million clients, with notable MFIs like Bandhan leading the industry. The Microfinance Bill, 2012, aims to streamline regulation and protect client interests, further strengthening the sector's role in financial inclusion and women's empowerment.

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