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Penetration of Microfinance Industry in India

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Abstract

Microfinance is an important institution and mechanism of credit delivery, particularly for the poor and deprived. A number of studies have been taken up in India and other developing countries which highlight the success of various microfinance programmes to alleviate poverty in rural areas, promoting holistic development of individuals, communities and developing small enterprises to promote entrepreneurship development particularly for the womenfolk. The importance of the microfinance programmes and the success of the institutions offering microfinance services in various developing countries come to the fore due to the persistent failure and non-responsiveness of the formal financial institutions in the sphere of rural development in general and rural credit in particular. In India there are two different models adopted for the delivery of microfinance services to the poor- Self Help Groups (SHGs) and Microfinance Institutions (MFIs). But the penetration of these two models have been uneven in the country with microfinance services remaining concentrated mainly to the Southern region of the country while the North and the North-Eastern region are still lacking the services of both the formal sources of finance and also the microfinance services. With this background the paper makes an attempt to look into the outreach of both the microfinance models in various regions of the country and construct a state-wise index of microfinance penetration.

Keywords: Microfinance, SHGs, MFIs, Microfinance Penetration Index

Introduction

Until about the mid-1960s the responsibility of meeting the credit needs in the rural areas of India was entrusted primarily to the co-operative banking sector. As the technological developments in the agricultural sector started gaining momentum, the commercial banks were expected to play an increasing role in the rural credit market through branch expansion and direct lending. The overriding objective of nationalization was the taking of banking to the masses (Christabell and Vimal 2012). The government envisaged that 40 percent of the total credit of the commercial banks should be channelised to priority sectors, groups or regions to support activities that were either considered to be socially beneficial or inherently risky and borrower groups that were likely to be marginalized in the credit markets, at lower interest rates. These measures had a strong impact on rural economy.

Although the banking system has experienced phenomenal growth in terms of geographical spread, deposit mobilization and disbursal of credit in rural areas after nationalization, bank credit remains by and large inaccessible to the poor. After more than six decades of independence, the formal financial institutions have not been able to ensure better and even distribution of credit. The very drive of the poor people to engage themselves through self-employment is not given priority by the formal financial sector that is yet to come out of their conventional mindset. As the poor have not been traditionally recognized as creditworthy, they are not perceived to be potential clientele for credit by the formal financial sector. Out of 63 million operational holdings below 1 ha of land, less than 25 percent had access to formal agricultural credit in 1990-91 (Vatta 2003). The Dantwala committee on RRBs concluded that the agricultural credit advanced by commercial banks had been additive and unable to fill the geographical credit gap not covered by the cooperatives. While informal lenders, despite its exploitative nature, still continue to occupy a sizeable share of the rural credit market. Collateral-free lending, proximity, timely delivery and flexibility in loan transactions are some of the attractive features of the informal credit system. In such a situation, formal credit still remains elusive for the rural poor.

In recent periods, banking sector witnessed tremendous changes in terms of technological advancements, internet banking, online money transfers, etc. But it is a reality that access to such technology is restricted only to certain segments of the society. Indeed, some trends, such as increasingly sophisticated customer segmentation technology have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle income population and a significantly large section of the population who lack access to even the most basic banking services. This is termed as "financial exclusion" (Christabell and Vimal 2012).

Amidst the distressed news, enthusiasm has been building about a set of unusual financial institutions prospering in distant corners of the country. These institutions united under the banner of "microfinance" share a commitment to serving clients that have been otherwise excluded from the formal banking sector and to carry forward the drive towards achieving 100 percent financial inclusion. Microfinance, in India, presently provides mainly savings and credit facilities under different models, viz., (a) the banks providing "no-frills" deposit facilities, remittances, insurance and small loans; (b) the self-help group (SHG)-bank linkage model; (c) the microfinance institutions (MFI) model; (d) post offices have also been providing small savings, remittance facilities and postal life insurance facilities (Karmakar 2009). Microfinance institutions have good potential in reaching out to the rural poor to bring them under the ambit of the formal financial system and to address the basic issues of rural development where the formal financial institutions have not been able to make significant headway.

Micro-credit has been defined as "programmes that provide credit for self-employment and other financial and business services to very poor persons" (Micro Credit Summit 1997). Microfinance can be interpreted in a broader context to contain both microcredit and micro savings even though microcredit and microfinance have come to be used interchangeably. Microfinance is a financial service of small quantity provided by financial institutions to the poor (Dasgupta 2005). These financial services may include savings, credit, insurance, leasing, money transfer, equity transaction etc, that is, any type of financial service, provided to customers to meet their normal financial needs: life cycle, economic opportunity and emergency with the only qualification that

(i) transaction value is small and (ii) customers are poor (Dasgupta and Rao 2003). Such a definition encompasses a large variety of initiatives ranging from individual agents in the informal sector (like moneylenders, traders, commission agents, jobbers, etc.), to informal groups (chit funds, rotating savings and credit associations) and formal sector institutions. However, there has been a growing tendency to use the term microfinance only to refer to formalised institutions. Thus, the World Development Report (2000-01) has described microfinance as a 'market-based formal mechanism' to hedge against the risks faced by poor people as compared to the 'informal group-based mechanisms' like savings and credit associations (Nair 2001).

There are two main models of micro credit in the country and they are the Self Help Group Bank Linkage Model (SBLP) and the 'MFI model' (Sinha 2009). In the case of the banking model Self Help Groups (SHGs) are formed and financed by banks. In some cases SHGs are formed by formal agencies/NGOs and financed by banks. In the MFI model, SHGs are formed and financed by the Microfinance Institutions (MFIs) that obtain resource support from various channels. While the MFI model is growing rapidly, the SBLP is by far the more dominant model in terms of outreach. Both these models are very different from each other in methodologies adopted and legal forms of institutions involved in service delivery- SBLP is run by the government while the MFI model is privately managed with some institutions being regulated by the Reserve Bank of India (Sinha 2009).

The SBLP which followed an exponential growth path for around 18 years till 2010, has shown in recent years signs of having levelled off. The data provided by NABARD for the year 2014 has shown a substantial decline of nearly 6 percent in the number of SHGs with outstanding bank loans to 4.2 million at the end of March 2014 as compared to the previous year (NABARD 2014). The southern region significantly contributed to the decline with the leading states with the leading states of Andhra Pradesh, Tamil Nadu, Karnataka and Kerala all registering a decline ranging from about 4 to 23 percent in the number of SHGs with loan outstanding. As for the changes in regional distribution, the share of the Southern states continued to increase both in number of SHGs covered and the amount of loans disbursed during 2013-14. The position of the

Western and Eastern regions has also marked improvements while the share of the Northern, North-Eastern and Central Regions experienced a decline during this period.

MFIs at present operate in 29 States, 5 Union Territories and 563 districts in India. As of March 2017, the reporting MFIs had nearly 11644 branches spread across India (Bharat Microfinance Report 2017). The total number of clients served by MFIs stood at 295 lakh as on 31 March, 2017. The majority of these clients are being served by NBFC-MFIs (81.82%), generally the larger ones. Out of the total client base, the North-Eastern and Northern regions have the least client outreach number with 5 percent and 4 percent respectively.

With this background the major objective of the study is to examine the outreach of microfinance across various states of India by constructing a Microfinance Penetration Index (MPI) on the basis of pre-determined dimensions.

Objectives

The study has been taken up with the following objectives:

(i) To look into the regional variation in the spread of SHGs.

(ii) To explore the outreach of Microfinance Institutions (MFIs) in various regions of the country.

(iii) To construct a state-wise index of microfinance penetration in the country.

Methodology

(i) Coverage of the Study

The present study is a macro level analysis and the area chosen for the study is the whole of Indian sub-continent.

(ii) Data Source

The study is based on mainly secondary sources of data. Data has been collected from various published reports of NABARD, Government of India, Bharat Microfinance Report, Inclusive India Finance Reports and other empirical research works.

(iii) Line of analysis

The line of analysis followed for the present study is of descriptive type. Data has been arranged and presented in tabular form for further analysis leading to the fulfilment of the first two objectives of the study. For the fulfilment of the third objective an index of microfinance penetration (MPI) has been constructed using the following formula (Srinivasan 2009).

$$MPI = \frac{\text{Share of microfinance clients in the state (in proportion to total clients of MFI and SHG models in India)}}{\text{Share of households in the state (in proportion to total households in India)}}$$

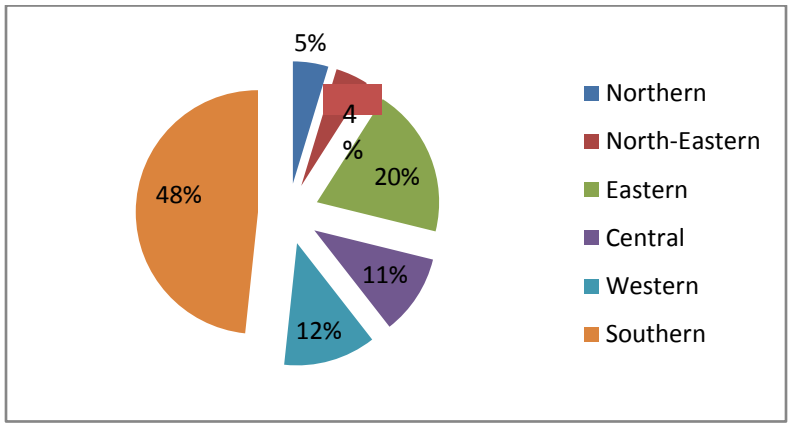
Findings and Discussions

The outreach of microfinance programmes across various regions in the country under both the models adopted in the country has been uneven. The Southern and Eastern regions are rich in terms of client outreach and loan portfolio both under the SBLP and MFI models. While the North-eastern and Northern regions have not made a significant headway in this regard with microfinance continuing to be in a nascent stage.

Spatial Distribution of SHGs

Distribution of SHGs in the country has always remained skewed towards the Southern region which accounts for almost half of the SHGs in the country (48 percent) followed by Eastern region with 20 percent share of the total SHGs in 2016-17 (NABARD 2017). Among the states Tamil Nadu has the maximum number of SHGs (12.8 percent). Compared to the previous year, there has been a marginal fall in the share of saving linked SHGs in the Southern region from 49.75 percent to 48.32 percent and in Northern region from 4.92 percent to 4.69 percent while the other regions have recorded a slight upward trend. In North-eastern region, apart from Tripura all other states and all the states in the Central region have recorded a rise in the number of savings linked SHGs during 2016-17 as compared to the previous year. The region-wise distribution of SHGs in India during the period 2016-17 has been presented in the figure below.

Figure 1: Distribution of SHGs across different regions of India

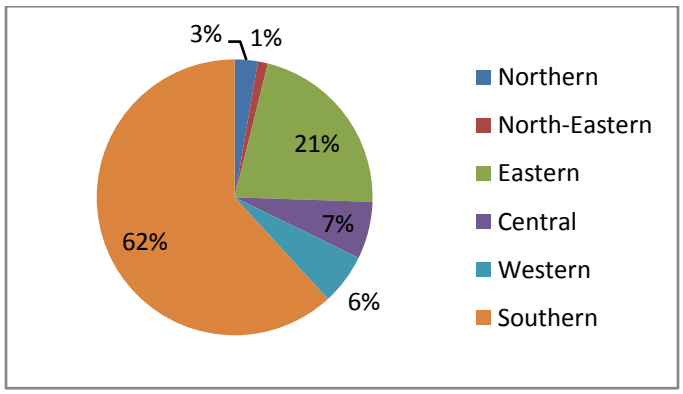


Source: Status of Microfinance in India 2016-17, NABARD

Region-wise Bank Loans Disbursed to SHGs

An analysis of region-wise distribution of SHGs with loan disbursement during 2016-17 shows that Southern region has the maximum share with 62 percent followed by Eastern region with 21 percent. Out of total 16.26 lakh SHGs which availed loans during 2016-17 one third (5.38 lakh) belonged to Andhra Pradesh and Telengana put together. States like Bihar, Odisha, Uttar Pradesh and Rajasthan have reported substantial increase in the number of SHGs credit linked and quantum of fresh loans extended while Jharkhand has shown a decline in the number and quantum of fresh loans issued. The North-Eastern region has the lowest share with only 1 percent loan disbursed to SHGs out of the total.

Figure 2: Region-wise Disbursement of loans to SHGs during 2016-17



Source: Status of Microfinance in India, 2016-17 NABARD

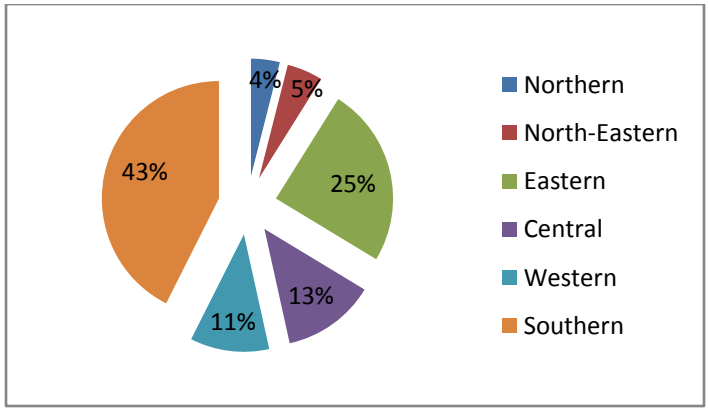
Regional Outreach of MFIs

According to The Bharat Microfinance Report 2017, MFIs currently operate in 29 states, 4 Union Territories and 563 districts in India. A total of 90 MFIs have confined their operations to only one state, while 57 MFIs have been continuing its operation in two to five states. 21 MFIs with a larger outreach and portfolio have their operations in more than five states, out of which four leading MFIs are operating in more than 15 states. MFIs with a relatively smaller scale or regional focus have concentrated their operations in one to two states only whereas other MFIs

have spread across a higher number of states in order to increase their scale of operations and at the same time mitigate the risk of concentrating in one particular area. MFIs which have been operating in many states are generally larger in size and follow the legal form of an NBFC-MFI.

Out of the total client base of 295 lakh, the Southern region contributes to 43 percent of the total, followed by 25 percent in Eastern region. The North-East and Northern regions have the least clientele share of the total with only 5 percent and 4 percent respectively. While the Central region and Western region have contributed to 13 percent and 11 percent of the total share respectively.

Figure 3: Distribution of MFIs across different regions during 2017-18

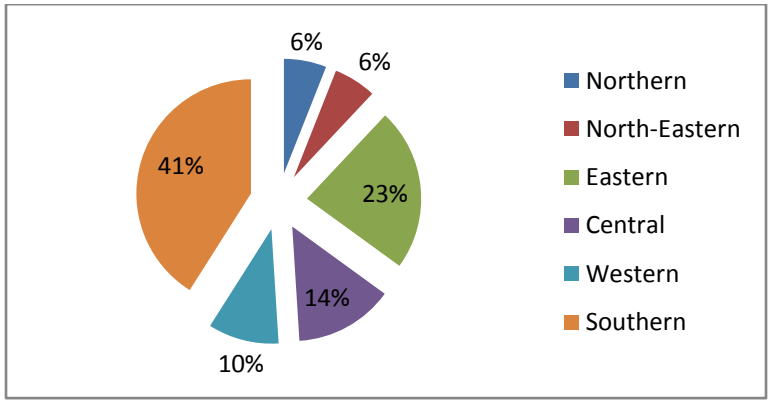


Source: The Bharat Microfinance Report 2017

Region-wise loan portfolio of MFIs

MFIs have been very instrumental in providing credit to clients outside the net of formal financial services. Among the various regions, the Southern region has been seen to dominate the overall loan portfolio outstanding of MFIs with 41 percent followed by Eastern region with 23 percent of loan portfolio. The North and Northeastern regions have continued to have the least share of loan portfolio with 6 percent each. While the Central and Western region have 14 percent and 10 percent loan portfolio share respectively.

Figure 4: Loan Portfolio of MFIs across different regions during 2017-18



Source: The Bharat Microfinance Report 2017

Microfinance Penetration Index

A regional analysis of microfinance spread across the country, as discussed above, has revealed a higher concentration in the southern states. The Southern states have been pre-dominant in microfinance activities since the very beginning although in recent years microfinance network is spreading at a substantial rate in the eastern and central regions of the country. This can be reflected in the Microfinance Penetration Index (MPI). This index was calculated for the first time in the year 2008 in the State of the Sector Report, 2008. The MPI provides estimates of the relative share of the states in microfinance clients as compared to their share in the population (Nair and Tankha 2015). It compares the distribution of microfinance clients to the distribution of total households in the country. Hence, a value of more than one indicates that the state's share in microfinance clients is more than proportional to its population thus indicating better than par performance. A score of less than one, which is the par value, indicates a comparatively poor performance by the state. The computation of the index is presented in the table below with the state-level scores.

Table 1: Microfinance Penetration Index during 2017-18

States	Total No. of SHGs with loan outstanding*	No. of SHG members*	No. of MFI Clients**	Total Microfinance Clients	Share of State to Total	Total Households	Share of households to total	MPI#
Andhra Pradesh	751357	9767641	104000	9871641	35.80	21024534	8.52	1.25
Arunachal Pradesh	239	3107	19200	22307	0.02	261614	0.11	0.22
Assam	101457	1318941	773600	2092541	2.26	6367295	2.58	0.88
Bihar	364169	4734197	2257512	6991709	7.55	18940629	7.68	0.98
Chhattisgarh	94018	1222234	535000	1757234	1.90	5622850	2.28	0.83
Delhi	415	5395	115000	120395	0.13	3143600	1.27	0.10
Goa	1598	20774	7050	27824	0.03	322813	0.13	0.23
Gujarat	48364	628732	460400	1089132	1.18	12181718	4.94	0.24
Haryana	22497	292461	383000	675461	0.73	4717954	1.91	0.38
Himachal Pradesh	16486	214318	13000	227318	0.25	1476581	0.60	0.41
Jammu & Kashmir	6034	78442	3000	81442	0.09	2015088	0.82	0.11
Jharkhand	87274	1134562	621000	1755562	1.90	6181607	2.51	0.76
Karnataka	649709	8446217	6833000	15279217	16.50	13179911	5.34	3.09
Kerala	142923	1857999	742120	2600119	2.81	7716370	3.13	0.90
Madhya Pradesh	91730	1192490	2053500	3245990	3.51	14967597	6.07	0.58
Maharashtra	227912	2962856	2133000	5095856	5.50	23830580	9.66	0.57
Manipur	1762	22906	73600	96506	0.10	507152	0.21	0.50
Meghalaya	1265	16445	12550	28995	0.03	538299	0.22	0.14
Mizoram	1378	17914	57460	75374	0.08	221077	0.09	0.90
Nagaland	2449	31837	4500	36337	0.04	399965	0.16	0.25
Odisha	220662	2868606	2294000	5162606	5.58	9661085	3.92	1.42
Punjab	11882	154466	546000	700466	0.76	5409699	2.19	0.35
Rajasthan	86484	1124292	628300	1752592	1.89	12581303	5.10	0.37
Sikkim	696	9048	11200	20248	0.02	128131	0.05	0.44
Tamil Nadu	384307	4995991	3225500	8221491	8.88	18493003	7.50	1.18
Tripura	33976	441688	43300	484988	0.52	842781	0.34	1.54
Uttar Pradesh	198174	2576262	2982000	5558262	6.00	32924266	13.35	0.45
Uttarakhand	14489	188357	192000	380357	0.41	1997068	0.81	0.51
West Bengal	669469	8703097	2116100	10819197	11.69	20067299	8.13	1.44
All India	4848287	63027731	29550000	92577731	100.00	246692667	100	1.00

Source: * Status of Microfinance in India, 2016-17, NABARD

** The Bharat Microfinance Report 2017, Sa-Dhan # -- Own Calculations

The table above highlights the state-wise index of microfinance penetration which has been calculated on the basis of pre-determined dimensions. As can be seen from the table, almost all the Southern states have recorded huge number of microfinance clients in comparison to the other states, both in respect of SHG members and MFI clients. The highest number of microfinance clients has been observed in Karnataka with more than 1.5 crore clients followed

by West Bengal and Andhra Pradesh; while the lowest number of microfinance clients has been observed at Sikkim with only 20,248 clients. In the North-Eastern region, baring Assam (20.92 lakh clients), all other states in this region have a miniscule share out of the total microfinance clients of the country. The Northern states viz., Delhi, Uttarakhand, Himachal Pradesh and Jammu & Kashmir also have a smaller proportion of microfinance clients relative to the Southern and Eastern states. The Microfinance Penetration Index (MPI) in the table above reveals that there is concentration of the microfinance Sector in the Southern region with the Southern States leading in penetration. The top six states with high levels of penetration have been found out to be Karnataka with an MPI value of 3.09, Tripura (1.54), West Bengal (1.44), Odisha (1.42), Andhra Pradesh (1.25) and Tamil Nadu (1.18). The MPI value of more than one reflects that as the share of microfinance clients are in the numerator, so the clients obtained are more than proportional to the total population. With the microfinance penetration being low in Northern region, the lowest MPI value has been observed in Delhi (0.10). The bottom six states in respect of microfinance penetration have been found to be Delhi (0.10), Jammu & Kashmir (0.11), Meghalaya (0.14), Arunachal Pradesh (0.22), Goa (0.23) and Nagaland (0.25). Assam has achieved an MPI value of 0.88 which is slightly less than the par value of 1 and hence remains a potential region before the microfinance sector to tap the excluded sections of the population from the services of formal financial institutions. Other states which have achieved MPI values closer to one are Bihar (0.98), Kerala (0.90), Mizoram (0.90), Chhattisgarh (0.83) and Jharkhand (0.76).

Conclusion

Despite major structural changes in credit institutions and forms of rural credit in the post-independence period, the exploitation of the rural masses in the credit market is one of the most pervasive and persistent features of rural life in India. In most developing countries, a large segment of society, particularly low-income people has very little access to financial services, both formal and semi-formal. As a consequence, many of them have to necessarily depend either on their own or informal sources of finance and generally at an unreasonably high cost. In this

context, microfinance has emerged as a financial innovation tool to serve the millions of poor households that are out of reach of the formal banking and financial institutions. Microfinance has become, in recent years, a fulcrum for development initiatives for the poor, particularly in the Third World countries and is regarded as an important tool for poverty alleviation. In India microfinance has been operating through the two models of Self Help Group and Microfinance Institutions. Both these delivery models have penetrated deep into various regions of the country; but interestingly the Southern region has almost reached the level of saturation in terms of concentration of microfinance activities. While the North-Eastern region, which remains backward in terms of coverage by formal financial institutions, has still a lot remaining unexplored even for the microfinance sector. Access to safe, easy and affordable credit and other financial services by the poor and vulnerable groups, disadvantaged areas and lagging sectors is recognized as a pre-condition for accelerating growth and reducing income disparities and poverty. Access to a well-functioning financial system, by creating equal opportunities, enables economically and socially excluded people to integrate better into the economy and actively contribute to development and protects themselves against economic shocks. Therefore it is of utmost necessity for the microfinance delivery models to reach out to the hitherto unreached, excluded areas from the purview of formal financial system in order to alleviate poverty, reduce regional disparities, reduce inequalities and focus on skill building of the otherwise neglected sections of the society.

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