

Microfinance industry in india economics essay



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This industry report presents a detailed overview of the microfinance industry in India. The advent of new millennium witnessed significant developments in the Indian microfinance industry, which attracted the attention of several private sector and foreign banks.

The report analyzes the potential of Indian microfinance industry and examines the recent policies of Indian government to boost the growth of the industry. It describes various microfinance models popular in India and includes a note on the leading players in the Indian microfinance industry.

Microfinance in India is approaching a historic 'tipping point' that could lead to a massive poverty reduction in the next five to ten years[1]

- Grameen Foundation US in 2005.

WHAT IS UNIQUE ABOUT RURAL FINANCE?

Most people in developing countries live in rural areas; like their countries, they are poor and unable to save; and they need to be helped. These plausible assumptions resulted in a well-intentioned type of development assistance: subsidized targeted credit provided through special programs, administered by agricultural (and other) development banks (AgDBs). During the 1950s and 60s, directed agricultural credit was synonymous with rural development finance. The argument was subsequently extended to urban areas, where many of the rural poor had migrated, and they too became beneficiaries of subsidized targeted programs; these were mostly financed and administered by NGOs. In both cases, AgDBs and NGOs, donors played a crucial role in providing funds and methodologies.

As directed credit failed to deliver the expected results in terms of poverty alleviation and development, a new type of development finance has emerged during the 1990s, both in theory and in practice, backed by an emerging international consensus[2]

- Agricultural credit has been replaced by rural finance, ie, credit by a range of financial services including savings; the emphasis on agriculture by finance for a broad range of loan purposes
- Rural finance has been integrated into the financial system

INDIAN MICROFINANCE CONTEXT

Indian public policy for rural finance from 1950s to till date mirrors the patterns observed worldwide. Increasing access to credit for the poor has always remained at the core of Indian planning in fight against poverty. The assumption behind expanding outreach of financial services, mainly credit was that the welfare costs of exclusion from the banking sector, especially for rural poor are very high. Starting late 1960s, India was home to one of largest state intervention in rural credit market and has been euphemistically referred to as ' Social banking' phase. It saw nationalization of existing private commercial banks, massive expansion of branch network in rural areas, mandatory directed credit to priority sectors of the economy, subsidized rates of interest and creation of a new set of rural banks at district level and an Apex bank for Agriculture and Rural Development (NABARD[3]) at national level. These measures resulted in impressive gains in rural outreach and volume of credit. As a result, between 1961 and 2000 the average population per bank branch fell tenfold from about 140

thousand to 14000 (Burgess & Pande, 2005[4]) and the share of institutional agencies in rural credit increased from 7.3% 1951 to 66% in 1991[5].

These impressive gains were not without a cost. Government interventions through directed credit, state owned Rural Financial Institutions (RFI) and subsidized interest rates increased the tolerance for loan defaults, loan waivers and lax appraisal and monitoring of loans. The problem at the start of 1990s looked twofold, the institutional structure was neither profitable in rural lending nor serving the needs of the poorest.

Successful microfinance interventions across the world especially in Asia and in parts of India by NGOs provided further impetus. In this backdrop, NABARD's search for alternative models of reaching the rural poor brought the existence of informal groups of poor to the fore. It was realised that the poor tended to come together in a variety of informal ways for pooling their savings and dispensing small and unsecured loans at varying costs to group members on the basis of need. This concept of Self-help was discovered by social-development NGOs[6] in 1980s. Realising that the only constraining factor in unleashing the potential of these groups was meagreness of their financial resources, NABARD designed the concept of linking these groups with banks to overcome the financial constraint. The programme has come a long way since 1992 passing through stages of pilot (1992-1995), mainstreaming (1995-1998) and expansion phase (1998 onwards) and emerged as the world's biggest microfinance programme in terms of outreach, covering 1.6 million groups as on March, 2005[7]. It occupies a pre-eminent position in the sector accounting for nearly 80% market share in India.

MICROFINANCE – A JOURNEY OF PROGRESS

In the 1970s a paradigm shift started to take place. The failure of subsidized government or donor driven institutions to meet the demand for financial services in developing countries led to several new approaches. Some of the most prominent ones are presented below.

Bank Dagan Bali (BDB) was established in September 1970 to serve low income people in Indonesia without any subsidies and is now “ well-known as the earliest bank to institute commercial microfinance”. While this is not true with regard to the achievements made in Europe during the 19th century, it still can be seen as a turning point with an ever increasing impact on the view of politicians and development aid practitioners throughout the world. In 1973 ACCION International, a United States of America (USA) based nongovernmental organization (NGO) disbursed its first loan in Brazil and in 1974 Professor Muhammad Yunus started what later became known as the Grameen Bank by lending a total of \$27 to 42 people in Bangladesh. One year later the Self-Employed Women’s Association started to provide loans of about \$1. 5 to poor women in India. Although the latter examples still were subsidized projects, they used a more business oriented approach and showed the world that poor people can be good credit risks with repayment rates exceeding 95%, even if the interest rate charged is higher than that of traditional banks. Another milestone was the transformation of BRI starting in 1984. Once a loss making institution channeling government subsidized credits to inhabitants of rural Indonesia it is now the largest MFI in the world, being profitable even during the Asian financial crisis of 1997 - 1998.

In February 1997 more than 2, 900 policymakers, microfinance practitioners and representatives of various educational institutions and donor agencies from 137 different countries gathered in Washington D. C. for the first Micro Credit Summit. This was the start of a nine yearlong campaign to reach 100 million of the world poorest households with credit for self employment by 2005. According to the Microcredit Summit Campaign Report 67, 606, 080 clients have been reached through 2527 MFIs by the end of 2002, with 41, 594, 778 of them being amongst the poorest before they took their first loan. Since the campaign started the average annual growth rate in reaching clients has been almost 40 percent. If it has continued at that speed more than 100 million people will have access to microcredit by now and by the end of 2005 the goal of the microcredit summit campaign would be reached. As the president of the World Bank James Wolfensohn has pointed out, providing financial services to 100 million of the poorest households means helping as many as 500 – 600 million poor people.

PRESENT SCENARIO OF MICROFINANCE IN INDIA

Microfinance sector has covered a long journey from micro savings to micro credit and then to micro enterprises and now entered the field of micro insurance, micro remittance, micro pension and micro livelihood. This gradual and evolutionary growth process has given a great boost to the rural poor in India to reach reasonable economic, social and cultural empowerment, leading to better life of participating households. Financial institutions in the country have been playing a leading role in the microfinance programme for nearly two decades now. They have joined hands proactively with informal delivery channels to give microfinance sector

the necessary momentum. During the current year too, microfinance has registered an impressive expansion at the grass root level.

The year 2008-09 is the third year that the data on progress in microfinance sector have been presented on the basis of returns furnished directly to NABARD by Commercial Banks (CBs), Regional Rural Banks (RRBs) and Cooperative Banks operating in the country. The data includes the information related to savings of Self Help Groups (SHGs) with banks as on 31 March 2009, loans disbursed by banks to SHGs during the year 2008-09 and outstanding loans of SHGs with the banking system and the details of Non-Performing Assets (NPAs) and recovery percentage in respect of bank loans provided to SHGs as on 31 March 2009. The data received from banks have been compiled on region-wise, State-wise and agency-wise basis in this booklet.

The banks operating, presently, in the formal financial system comprises of Public Sector Commercial Banks (27), Private Sector Commercial Banks (28), Regional Rural Banks (86), State Cooperative Banks (31) and District Central Cooperative Banks (371). It is observed that most of the banks participating in the process of microfinance have reported their progress under the programme.

NABARD has been instrumental in facilitating various activities under microfinance sector, involving all possible partners in the arena. It has been encouraging the voluntary agencies, bankers, socially spirited individuals, other formal and informal entities and also government functionaries to promote and nurture SHGs. The focus in this direction has been on training

and capacity building of partners, promotional grant assistance to Self Help Promoting Institutions (SHPIs), Revolving Fund Assistance (RFA) to MFIs, equity/ capital support to MFIs to supplement their financial resources and provision of 100% refinance against bank loans provided by various banks for microfinance activities.

LEGAL FORMS OF MFIS IN INDIA

Types of MFIs	Estimated Number*	Legal Acts which Registered Societies Registratio n Act, 1860 or similar Provincial Acts Indian Trust Act, 1882 Section 25 of the Companie s Act, 1956
1. Not for Profit MFIs	400 to 500	
a.) NGO - MFIs		
b.) Non-profit Companies	10	

2. Mutual

Benefit

MFIs

a.) Mutually
 Mutually Aided
 Aided Cooperativ
 Cooperati e Societies
 ve 200 to Act
 250
 Societies enacted
 (MACS) by State
 and Governme
 similarly nt
 set up
 institutio
 ns

3. For

Profit

MFIs

a.) Non- Indian
 Banking 6 Companie
 Financial Reserve
 Compani Bank of
 es India Act,
 (NBFCs) 1934

Total 700 - 800

SUCCESS FACTORS OF MICRO-FINANCE IN INDIA

Over the last ten years, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than market rates. Community banks, NGOs and grass root savings and credit groups around the world have shown that these microenterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

LIST OF NATIONALIZED BANKS WHO PROVIDE MICRO FINANCE SERVICES IN PUNJAB REGION

Public Sector Commercial Banks

- Allahabad Bank
- Bank Of Baroda
- Bank of India
- Bank of Maharashtra
- Canara Bank
- Central Bank of India
- Punjab National Bank
- Punjab & Sind BANK
- Union Bank of India
- Corporation Bank

Private Sector Commercial Banks

- HDFC Bank
- ICICI Bank
- Kotak Mahindra Bank
- Axis Bank
- Yes Bank

NEED & SCOPE OF MICROFINANCE

Microfinance has a profitable banking opportunity in India with over 11.36 million poor clients, 26 per cent of the total outreach of microfinance institutions of the world, meeting their financial needs from a range of organizations, including community-based microfinance networks and cooperatives. But importantly, there are 60 million potential clients of which 40-45 million are poor rural households. However, the major problem is to ensure a smooth flow of adequate amount of on-lending funds.

The microfinance is assisting 12 million self-help groups (SHG) in rural areas. There is also a large missing loan size that needs to be supplied by the microfinance institutions. India's bank infrastructure is in place and the economy looks robust with interest rates having been liberalized.

OBJECTIVES

- To study the microfinance services among fulfill the needs of rural people of Punjab
- To study the role of nationalized (commercial) Banks for promoting microfinance services in rural area of Punjab
- To study some challenges faced by commercial banks for encouraging spread of Microfinance services among rural population in Punjab

REVIEW OF LITERATURE

A literature review of the impact of microfinance

07 Jun 2009

A primer on Microfinance India

The article is interesting. But microfinance in India is copying the Grameen Bank (Md. Yunus) model, in the name of SHG; just because it has been tried, tested and won a Noble prize . It has not made the poor rich. And the model somehow is out of tune with present conditions. It is high time MFIs in India came up with some original ideas and innovations. Microfinance is not only about recovery of money lent (which is a good statistic tool) it is also about improving the standard of living of the beneficiaries. To be successful MFIs have to think outside the square and not be afraid to experiment. It is high time we moved on from the Grameen bank model.

Microfinance in India has a long way to go: Vikram Akula

Article from: The Hindustan Times

Article date: November 28, 2006

New Delhi, Nov 28

Microfinance in India is growing exponentially but it has a long way to go, says Hyderabad-based Vikram Akula, winner of the Social Entrepreneur Award of the Schwab Foundation 2006. Akula, founder and chairman of SKS Microfinance Private Limited, shifted to the US at the age of three. However, India's ever-growing poverty brought him back to the country.

“ Microfinance in India is a growing sector but it has a long way to go and much more needs to be done before we can successfully help our poor with

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the support of credit and microfinance,” Akula told IANS in an interview.” The regulatory environment created by the Reserve Bank of India (RBI).

The Economic Lives of the Poor

Abhijit V. Banerjee and Esther Duflo; Abdul Latif Jameel Poverty Action Lab, MIT

October 2006

This paper uses survey data from 13 countries to document the economic lives of the poor (those living on less than \$2 dollar per day per capita at purchasing power parity) or the extremely poor (those living on less than \$1 dollar per day). We describe their patterns of consumption and income generation as well as their access to markets and publicly provided infrastructure. The paper concludes with a discussion of some apparent anomalous choices.

Do Rural Banks Matter? Evidence From The Indian Social Banking Experiment

Robin Burguess & Rohini Pande; LSE, Yale University

August 2003

Lack of access to finance is often cited as a key reason why poor people remain poor. This paper uses data on the Indian rural branch expansion program to provide empirical evidence on this issue. Between 1977 and 1990, the Indian Central Bank mandated that a commercial bank can open a branch in a location with one or more bank branches only if it opens four in locations with no bank branches. We show that between 1977 and 1990 this rule caused banks to open relatively more rural branches in Indian states with lower initial financial development. The reverse is true outside this period. We exploit this fact to identify the impact of opening a rural bank on poverty and output. Our estimates suggest that the Indian rural branch

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expansion program significantly lowered rural poverty, and increased non-agricultural output.

Effects of Financial Access on Savings by Low-Income People

Fernando Aportelo, Bank of Mexico

December 1999

This paper assesses the impact of increasing financial access on low-income people savings. Effects on households' saving rates and on different informal savings instruments are considered. The paper uses an exogenous expansion of a Mexican savings institute, targeted to low-income people, as a natural experiment and the 1992 and 1994 National Surveys of Income and Expenditures. Results show that the expansion increased the average saving rate of affected households by more than 3 to almost 5 percentage points. The effect was even higher for the poorest households in the sample: their saving rate increased by more than 7 percentage points in some cases. Furthermore, the expansion, in general, had no effect on high income households. In the case of informal savings instruments, evidence of crowding out of these instruments caused by the expansion is limited. Results do not rule out the possibility that a considerable fraction of the increase in households' savings could have come from new savings.

The Impact of Microcredit

The miracle of microfinance? Evidence from a randomized evaluation

Abhijit Banerjee, Esther Duflo, Rachel Glennerster, Cynthia Kinnan; MIT Jameel Poverty Action Lab, Indian Centre for Micro Finance, Spandana

October 2009

Hyderabad, India

The researchers from the Abdul Latif Jameel Poverty Action Lab (J-PAL) at MIT and the Indian Centre for Micro Finance worked with Spandana to randomize

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the roll-out of its microcredit operations in Hyderabad, India's fifth-largest city. Spandana chose 104 areas of the city to expand into eventually, rejecting some districts as having too many construction workers, who come and go and might take Spandana's money with them. In 2006–07 Spandana started lending in a randomly chosen 52 of the 104. Researchers followed up by surveying more than 6, 000 households between August 2007 and April 2008, restricting their visits to families that seemed more likely to borrow: ones that had lived in the area at least three years and had at least one working-age woman. The surveyors made sure not to visit an area until Spandana had been there at least a year. They surveyed in “treatment” areas (ones where Spandana worked) and control ones (where it did not yet).

Expanding Microenterprise Credit Access: Using Randomized Supply Decisions to Estimate the Impacts in Manila

Dean Karlan, Jonathan Zinman;

Yale University, Dartmouth College, IPA, Financial Access Initiative, MIT Jameel Poverty Action Lab

July 2009

Microcredit seeks to promote business growth and improve well-being by expanding access to credit. We use a field experiment and follow-up survey to measure impacts of a credit expansion for microentrepreneurs in Manila. The effects are diffuse, heterogeneous, and surprising. Although there is some evidence that profits increase, the mechanism seems to be that businesses shrink by shedding unproductive workers. Overall, borrowing households substitute away from labor (in both family and outside businesses), and into education. We also find substitution away from formal insurance, along with increases in access to informal risksharing mechanisms. Our treatment effects are stronger for groups that are not

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typically targeted by microlenders: male and higher-income entrepreneurs. In all, our results suggest that microcredit works broadly through risk management and investment at the household level, rather than directly through the targeted businesses.

The Impact Of Micro Savings

Savings Constraints and Microenterprise Development: Evidence from a Field Experiment in Kenya

Pascaline Dupas and Jonathan Robinson; UCLA, UCSC, NBER

March 2009

We conducted a field experiment to test whether savings constraints prevent the self-employed from increasing the size of their businesses. We opened interest-free savings accounts in a village bank in rural Kenya for a randomly selected sample of poor daily income earners. Despite the fact that the bank charged substantial withdrawal fees, take-up and usage was high among women and the savings accounts had substantial, positive impacts on their productive investment levels and expenditures. These results imply that a substantial fraction of daily income earners face important savings constraints and have a demand for formal saving devices (even for those that offer negative de facto interest rates).

Female Empowerment: Impact of a Commitment Savings Product in the Philippines

Nava Ashraf, Dean Karlan, Wesley Yin; HBS and Jameel Poverty Action Lab, Yale, University of Chicago

March 2008

Female “empowerment” has increasingly become a policy goal, both as an end to itself and as a means to achieving other development goals.

Microfinance in particular has often been argued, but not without

controversy, to be a tool for empowering women. Here, using a randomized controlled trial, we examine whether access to and marketing of an individually-held commitment savings product leads to an increase in female decision-making power within the household. We find positive impacts, particularly for women who have below median decision-making power in the baseline, and we find this leads to a shift towards female-oriented durables goods purchased in the household.

Tying Odysseus to the Mast: Evidence from a Commitment Savings Product in the Philippines

Nava Ashraf, Dean Karlan, Wesley Yin

July 2005

We designed a commitment savings product for a Philippine bank and implemented it using a randomized control methodology. The savings product was intended for individuals who want to commit now to restrict access to their savings, and who were sophisticated enough to engage in such a mechanism. We conducted a baseline survey on 1777 existing or former clients of a bank. One month later, we offered the commitment product to a randomly chosen subset of 710 clients; 202 (28.4 percent) accepted the offer and opened the account. In the baseline survey, we asked hypothetical time discounting questions. Women who exhibited a lower discount rate for future relative to current tradeoffs, and hence potentially have a preference for commitment, were indeed significantly more likely to open the commitment savings account. After twelve months, average savings balances increased by 81 percentage points for those clients assigned to the treatment group relative to those assigned to the control

group. We conclude that the savings response represents a lasting change in savings, and not merely a short-term response to a new product.

Research Methodology

Need For Study

To Role of nationalized banks in promoting microfinance services among rural people of Punjab

Research Objective

- To study the microfinance services among fulfill the needs of rural people of Punjab
- To study the role of nationalized (commercial) Banks for promoting microfinance services in rural area of Punjab
- To study some challenges facing by commercial banks for promote Microfinance in rural area of Punjab

Data Collection.

Sources Of Data

- Primary Data Source
- Secondary Data Source

Both primary and secondary data sources have been used for data collection.

Primary Data Source-The major source of data was the “ Primary source”

Primary data was collected from:-

- Survey-Questionnaire

The major source of data was from the primary source. The primary data was collected from a sample of 150 respondents, by circulating the questionnaire to the respondents.

Secondary source - Secondary data was collected from different journal and reports on Micro Finance Activities.

Sampling tool- Data has been collected by preparing a set of questionnaire.

Sample Design

I have taken the sample design of 150.

Data Analyzed.

Data will be analyzed through survey which is going to be held in some part of Punjab Region.

Report Writing.

Report is going to be prepared in case of descriptive and diagnostic research studies, where descriptive research studies are those studies which are concerned with describing the characteristics of particular individual, or of a group, whereas diagnostic research studies determine the frequency with which something occurs or its association with something else. The studies concerning whether certain variables are associated are of diagnostic research studies. As against this, studies concerned with specific predictions, with narration of facts and characteristics concerning individual, group or situation are all examples of descriptive research studies.

Chapterisation Scheme

The purposed study will be divided into the following chapters:

- Introduction to microfinance services in rural area of Punjab
- Need and scope of microfinance
- Objectives of study.
- Review of the Literature
- Research Methodology
- Presentation and Analysis of the Data
- Interpretation of data.
- Summary & Suggestions
- Bibliography & References.

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