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Micro Finance as a Tool for Financial Inclusion of Rural India

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ABSTRACT *India tagged as a low income class country by World Bank and houses the second largest world population. Out of the total population which resides in India more than 50% of the population is still living in rural area and therefore need credit and financial services. This lead to advent of micro-credit, and therefore NABARD initiated the concept of Microfinance in the country which was aimed at providing financial services to rural population of the country. A number of microfinance models are currently operational in country; however there are a number of issues which makes the system laggard. Recommendations at the end of this paper have been laid down with regard to how the problems of microfinance system can be resolved.*

Introduction to Microfinance

Microfinance can be defined as small savings, credit and insurance services which extended to poor in rural, semi urban and urban areas, in order to enable them to raise their income level and also improve their living standards (Nasir S., 2013). In the last few years, immense growth has been observed in the microfinance sector of India. The concept of microfinance is not new in India, as people have always been borrowing and lending money, however this system is far more organized and has been primarily developed in response fulfill the needs of low income groups of India which have not been satisfied by the commercial banks and other financial institutions of the country (Singh and Yadav, 2012).

History of Microfinance in India

National Bank for Agriculture and Rural Development (NABARD) was set up in 1992, which initiated a pilot project of promotion of 500 self help groups (SHG). The idea initiated by NABARD was encouraged both by the banking sector as well as RBI who then issued instructions to government sector banks after four year in 1996 to cover SHG financing. SHGs was linked as a national priority with banks by the government of India in 1999 after the announcement of periodic policy and budget announcement. The programme has gained momentum in the last two decade and is currently providing support to 2.5million households annually. The reach is such that, the program has gained maximum outreach across rural India (Moses E., 2011).

Key Issues in Microfinance Sector of India

Outreach in India is low: The outreach of microfinance sector in rural India is only 8%. It has been observed that the program is focused on primarily on rural women. It has been argued that women are reliable clients as they have better saving potential and their repayment performance is also better than men. This has inclined the Microfinance institutions (MFI) towards women. However since not many rural India women apply for loans the overall outreach of the program is reduced (Sarumathi, S. and Mohan K., 2011).

High Rate of Interest: The interest rate charged by MFIs is very high which the poor are unable to payback. Since most the MFIs in the country are privatized and do not receive and subsidized credit, in order to recover their cost they pass their burden to back to borrowers (Thorat, Y.S.P., 2006).

Poor Population in Urban Areas is neglected by MFIs: There are currently 800 MFIs in the country out of which only 6 MFIs are paying attention to the needs of urban poor which is a very low percentage. The rate of urbanization is increasing day by day which will also lead to rapid rise in percentage of urban poor (Thorat, Y.S.P.,, 2006).

Low Client Retention: The client retention rate is also only 28% in India. Low client retention is due to lack of information and proper education about the services available to the poor (Thorat, Y.S.P., 2006).

Geographic Barriers: Nearly 50% of the India resides in villages and around 60% of MFIs functioning in the country are unable to reach and communicate with secluded area which in turn also affects the outreach of these services (Thorat, Y.S.P., 2006).

Different types of options for microfinance in rural areas

Microfinance is a dynamic field in country and therefore a number of models have been developed which provide financial services. The five main delivery models in microfinance in India which exist today are (Bharti N., 2007):

Self Help Groups: SHGs have evolved from the NGOs, and help in providing networking and education facilities to rural women in India. 90% of these groups are able to provide their services to rural women as they are breadwinners in most rural households. SHG is a small group of 20 people, who voluntarily work towards a common goal.

Federated Self Help Groups: Since SHGs are smaller in size, they can provide only limited resources. Based on a similar model FSHGs were developed, which include 1000 members and has a three tier working structure. While at the base level there is a SHG, then at middle level there is a cluster and at the top level there is a apex body. Some of the FSHGs currently operational in the country are; PRADAN, SEWA and Chaitanya.

Grameen Bank: This model was first introduced in Bangladesh, and received immense success. Since then, several initiatives[1] were launched based on the model of Grameen Bank. There are a number of advantages of this model like low transaction cost, no collateral, loan repayment schemes are easier, loans are sanctioned quickly without any formalities and with little paper work.

Co-operative Bank: This model is owned by the members who are using its services. The members can come from different sectors of the society, and therefore the locals operate and control the functioning of this institution with little or no interference from other parties. Sahavikasa, founded in 1975 is among the leading co-operative in India.

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Microfinance Institutions: These institutions area developed by GOI to provide financial services to the poor in India. They work on the concept of Joint Liability Group (JLG), wherein 5-10 people avail loans through mutual guarantee. There are four categories of MFIs i.e. NGOs, Non-Profit companies, Mutual Benefit MFIs and Non-Banking Financial Companies.

Micro finance as a tool for financial inclusion of rural India

There are five factors which reflect the need of financial inclusion in rural India. These are (Shankar S., 2013):

- Inability to access financial services;
- Lack of access to safe and formal saving avenues like banks;
- Lack of credit products in which investment can be made;
- Lack of remittance products which makes money transfer a cumbersome affair;
- Lack of insurance products which makes risk management a distant dream for poor.

As can be observed from the points listed above, there is lack of proper credit system in the rural India which makes it necessary to develop institutions which can extend credit to the poor population of India. The microfinance services provide credit and saving facilities to people so that poverty can be reduced in the country. These services help people so that they can self-employ themselves (Srinivasan, N., 2009). Also it gives wider financial services like savings, insurance, remittance to the poor population (Tankha, 1999). These services help in bridging the gap between formal financial markets and informal groups (Discussed in previous section). The main reason behind incorporating informality in the system is because they want the poor would be able to trust these services more. The microfinance movement for financial inclusion has brought profound transformation in the rural India and MFIs have played a significant role in facilitating inclusions. Currently 1000 NGO MFIs and more than 22 lakh SHGs have reached the different parts of the country and plans to reach 50% of the rural women population in next five years.

Conclusion and recommendations

As per the findings of secondary research, the concept of Microfinance is only two decades old and has only been able to reach the rural women population of the country. Also there are a number of issues associated with the Microfinance system which plague the system and therefore the researcher has presented some recommendations as to how these issues can be resolved.

The outreach of the program should be enhanced not only to women but also to the men in the Indian society. This can be achieved by reducing the high interest rates on loans so that the even men are able to repay their loans on time.

It is also important for the NGOs to be willing to operate at low margins and bear low interest rates in order to maintain the balance between the objective of initiating the concept of microfinance in the country. The commercial viability and the purpose of serving the poor should be resolved.

MFIs should also pay equal attention to the poor population living in the urban cities of the country as they have to harsh financial problems. The per capita operational income required in urban cities is very high in comparison to rural parts of the country.

Most the Rural Indian population is uneducated, who cannot manage their loans properly. So therefore, proper educational facilities should also be provided so that they can manage their debt, which in turn with promote the growth and expansion of the SHGs in the country.

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