

ROLE OF MICROFINANCE INSTITUTIONS IN FINANCIAL INCLUSION IN INDIA

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ABSTRACT

Financial Inclusion is delivery of basic banking services at an affordable cost to the vast sections of disadvantaged and low-income groups. Government of India has been trying since independence to reach the low-income and under privileged through many schemes / policies. Microfinance is a type of banking service provided to the unemployed or low-income individuals or groups as an opportunity to become self-sufficient, which otherwise would have no other access to financial services. An attempt has been made in this paper to study the role of microfinance institutions towards financial inclusion in India.

Keywords: *Micro finance, Financial Inclusion, Under privileged, Low income group.*

Introduction

Policy formulation is the primary responsibility of every government worldwide. Considered factors, while formulating policies, are geared for achieving targeted outcomes and is country specific. Irrespective of countries and governments, the most desirable objective is economic growth. A general understanding associated with economic growth is improved living standard for every citizen. However this understanding is theoretical. In reality the economic growth has negligently helped in improving the standard of living for all but few, thereby contributing in creating growing inequality within the nation; across sectors, sections and individuals. The said inequality in terms of income and wealth is not limited to its distribution but its effect is cascading to such an extent that the most wishful

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government agenda of growth model gets adversely impacted. This skewed resource distribution coupled with skewed participation in economic activities results in under leveraged growth rate (growth model). Realizing this policymakers worldwide have adopted various measures to address the issue; one such measure is **Financial Inclusion Program**, referred as **Financial Inclusion**.

Literature Study

Patnaik, Satpathy, Mahapatra & Supkar (2012)(22)- State lack of regular and substantial income is one of the reasons for the financial exclusion. People with low income do not qualify for a loan. The proximity of the financial services is another fact. The loss is not only the transportation cost but also the loss of daily wages for a low income individual. Most of the excluded customers are not aware of the bank's products, which are beneficial for them Gwalani & Parkhi (2014) (7) - Various policies have been adopted in India to increase the same. Though all roads lead to Rome, the agenda needs to be more focused and should be more attentive towards the causes of the failure.

Dinesha & Vedamani (2018) (5) says MFIs are essential to encourage micro enterprises and empower local people including women. The geographical distribution of MFIs is very much concentrated in the Southern India where the rural branch network of formal bank is excellent.

Financial Inclusion

Financial Inclusion is a remedial measure targeted to address the issue of growing inequality. Financial Inclusion is not a tool by itself rather a package consisting of varied services. In the context of growing inequality, this article will examine different facets of Financial Inclusion in details in the following order:

1. Financial Inclusion - an analysis.
2. The role of Micro Finance Institutions - a subset of Financial Inclusion.

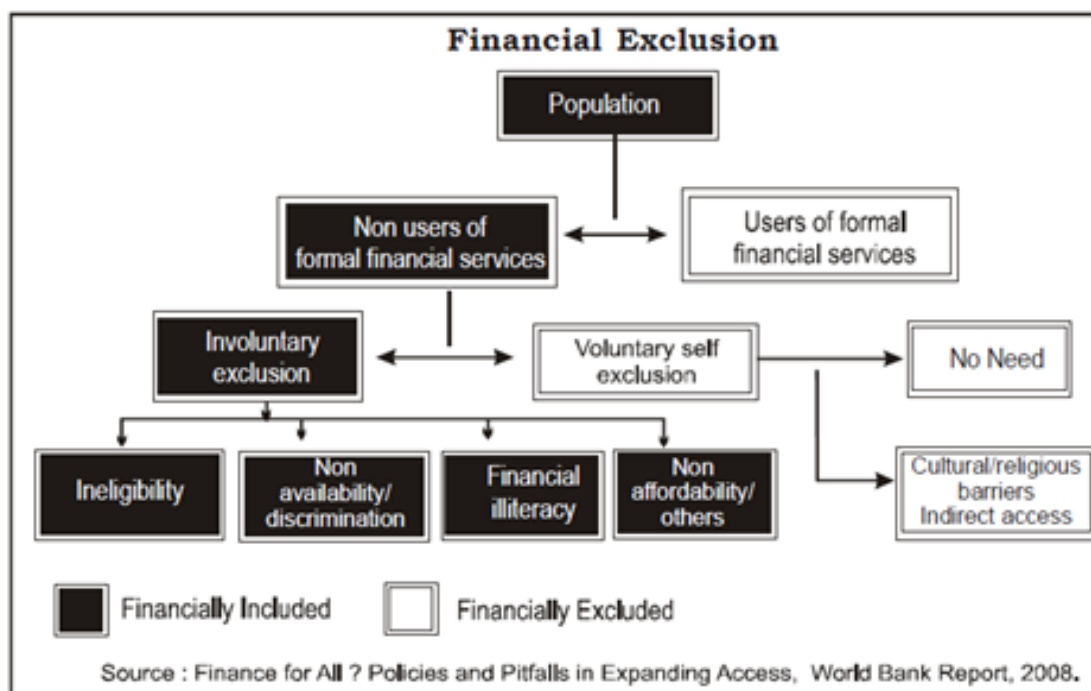
In this section we will examine what is Financial Inclusion and why Financial Inclusion. The simplistic and concise meaning of the term Financial Inclusion is access to financial services for everybody. To better understand what is Financial Inclusion, let's understand why Financial Inclusion and its context. And the answer is inclusive approach for inclusive growth i.e. includes everybody in all the economic activities within the nation in a planned manner. This approach ensures balanced growth, contrary to rich getting richer and poor getting poorer. With this basic understanding let us examine Financial Inclusion in greater detail.

IRDB definition of the term Financial Inclusion is; “Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way.”

Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost (The Committee on Financial Inclusion, Chairman: Dr. C. Rangarajan).

So, the broader objective of Financial Inclusion Program is the access to formal Financial Services (we will discuss shortly) for everybody: 1) those excluded so far from Financial Inclusion Program; and 2) included but unable to take advantage of this program effectively. Primarily, the program is geared targeting low income households and family businesses being the most vulnerable sections of the society.

Forthwith our analysis on Financial Inclusion will be “low income households and family businesses (referred to as Excluded Group)” centric.



After having said so much about Financial Inclusion and its usefulness, can this directly be implemented? The answer is no, for the reason Financial Inclusion is not a product per se but a product basket of **Financial Services**. Services under Financial Inclusion, listed in order of demand by the Excluded Group are:

- a. Payment services
- b. Saving services
- c. Microcredit credit services
- d. Insurance services

Financial Inclusion Program merely with Financial Services is an incomplete model and can't be implemented as such. The model to be effective must have the following Compatible Qualitative Factors:

- a. Sustainable model
- b. Fair pricing
- c. Effective delivery system
- d. Socially responsible
- e. Education and awareness

So, the understanding of Financial Inclusion so far is Financial Services designed with Compatible Qualitative Factors. A successful Financial Inclusion Program not necessarily implements the components of Financial Services and Compatible Qualitative Factors in a particular sequence but in any sequence, more, the implementer can leave few- therefore need based. So it becomes imperative to understand each components must evaluate program efficacy and successful implementation. Till now Micro Finance Institutions (MFIs) have played as an important component or as a subset towards Financial Inclusion.

Micro-Finance and its Role

After independence, the banks and financial institutions provided credit primarily to the upper classes of society. Around 70 per cent (MFIN Micrometer reports FY14-18) of the total borrowing in the country was through informal sources. Nationalisation of bank in 1969, 1980 and formation of Regional Rural banks in early 1970s didn't help much towards Financial Inclusion thus created serious need for alternate source of formal credit. Government of India formed National Bank for Agriculture and Rural Development (NABARD) in 1982, to support the needy and underprivileged income group for providing credit.

Evolution of Microfinance in India

NABARD initiated the SHG 'Self Help Group' lending model in India with the policy support of the Reserve Bank of India and was further extended to banks. The essence of the model was to move from paper-backed collateral to socially-backed collateral from a group in geographical proximity.

Most of the institutions that forayed into the sector were from the social sector and hence the legal entities comprised Trusts, Societies or Section 25 Companies. As the industry continued to grow, the non-profit form became a limiting factor in making these

institutions sustainable and scalable. Based on the recommendations of the Malegam Committee, January 2011, RBI created a new subset under the Non-Banking Finance Companies (NBFCs) for institutions specializing in microfinance and called them NBFC-MFIs.

Microfinance, also called microcredit, is a type of banking service provided to unemployed or low-income individuals or groups an opportunity to become self-sufficient, which otherwise would have no other access to financial services. While institutions participating in the area of microfinance most often provide lending— new microloans cap proposed by Microfinance Institutions Network (MFIN) is set at Rs. 80000, up from Rs. 60000 (was in force since 2013) under the joint liability group model to cover inflation of recent years. This will also help borrowers to enhance their capacity to start or support small business growth. But the cost of debt on the part of the borrowers is very high, as the usual interest charges to them is between 26% to 30%. NBFC-MFIs carry a high risk of default hence they charge higher interest rate. Since February 2014, The Reserve Bank of India has removed the cap of 26% interest rate on loans. So MFIs can fix the lending rate by adding their cost of funds with a maximum 10% margin or taking the lowest of the average base rate of the top five commercial banks by assets multiplied by 2.75 times.

There is a reason why the cost of funds for NBFC-MFIs is high; they are not getting enough supports from the banks as they are not regulated by the RBI, even after contributing so much towards Financial Inclusion.

In India, currently there are three models prevalent in the Microfinance field – JLG (Joint liability group), SHG (Self-help group) and SHG Bank linkage. NBFC-MFIs and Small Finance Banks follow the JLG and SHG models, whereas commercial, corporate and regional rural banks follow the SHG bank linkage model. Over the years, a hybrid model has been evolved picking up certain best practices and processes from the models SHG and JLG.

NBFC-MFIs have been playing a significant role in taking forward the financial inclusion vision of the Government of India. What sets the NBFC-MFIs apart is the fact that they do

not depend on grants or subsidies to provide unsecured loans to people with low incomes and with negligible access to the banking system. As on 31st March 2019, NBFC-MFIs provided credit to over 3.22 crores clients in India, with a total lending more than Rs.83,200 crores.

As of March 31, 2019, MFIs provide microcredit to over 6.40 crores clients. The microfinance industry has a presence in 615 districts in India whose 210 districts constitute 80% of the portfolio outstanding. As per industry body Microfinance Institutions Network (MFIN), the regional distribution of portfolio (GLP) of NBFC-MFI currently stands as: East and North-East (37%), West (15%), South (25 %), North (14%) and Central India (9%).

Microfinance Industry: Core Strengths

1. Regulated by the Reserve Bank of India with MFIN as the SRO for the industry
2. Stringent Industry Code of Conduct in place
3. Feet on Street delivery model which ensures doorstep delivery to clients
4. Bouquet of products such as microcredit, micro insurance and micro pension
5. Presence in under banked and underserved places
6. Financial literacy and awareness integrated to product delivery
7. Conducive environment for clients with local culture, local employees and high customer connectedness

The MFI scenario for the entire industry as of 31st March 2019:

Particulars	Banks	SFBs	NBFC-MFIs	NBFCs	Not for Profit MFIs	Total Industry
Unique Live Borrowers ('000)	17,849	11,894	25,533	8,047	780	64,103
Active Loans ('000)	22,509	14,914	39,340	8,780	924	86,467
Portfolio	59,999	29,990	68,156	18,539	1,863	178,547

Outstanding (crore)						
Market Share in Outstanding Portfolio (in %)	34	17	38	10	1	100
Disbursed Amount (` crore) - FY 2019	78,596	31,673	83,200	17,448	2,157	213,074
Average Ticket Size (in `) FY 2019	42,086	30,780	25,850	31,722	29,656	31,623

Source: SIDBI Microfinance Pulse Vol II – June 2019

Table: 1

Table: 1 reflects

- a) NBFC-MFIs are clearly ahead in all the parameters of the industry
- b) NBFC-MFIs are having highest no. of customers
- c) As per disbursement NBFC-MFIs have the highest 39.04% market share with Disbursed amount of RS.83,200 crores
- d) As per Outstanding Portfolio NBFC-MFIs have market share of 38%

To understand better the contribution of NBFC-MFIs, the above table can further be broken up with a comparison of last 3 years performance.

Portfolio Outstanding (in ` crore):

Particulars (as on March 31st)	FY 2016	FY 2017	FY 2018	FY 2019
Banks	21,175	33,176	43,914	59,999
SFBs	-	32,384	23,160	29,990
NBFC-MFIs	34,067	31,992	45,794	68,156
NBFCs	20,525	6,974	12,740	18,539
Not for Profit MFIs	2,355	1,467	1,616	1,863
Total Industry	78,123	105,994	127,223	178,547

Source: SIDBI Microfinance Pulse Vol II – June 2019

Table: 2

Table: 2 reflects

- a) NBFC-MFIs have the highest portfolio outstanding growth at 49% across all categories of lenders as at end of FY 2019 compared to previous year
- b) Portfolio outstanding for NBFC-MFIs as on March 31, 2019 is Rs.178,547 crores and had a YOY growth of 40% over previous year
- c) In the FY 2017 Banks had the highest Portfolio outstanding, but in the FY 2018 NBFC-MFIs overtook the banks with the figure of Rs.45.794 crores. In the FY 2019 it consolidated further with the figure of Rs.68,156 crores compared to bank figures of Rs.59.999 crores.

No. of Loans Disbursed (in Lakh)

Particulars (as on March 31st)	FY 2016	FY 2017	FY 2018	FY 2019
Banks	125	129	141	187
SFBs	120	99	88	103
NBFC-MFIs	213	219	277	322
NBFCs	37	31	49	55
Not for Profit MFIs	21	7	7	7
Total Industry	516	485	562	674

Source: SIDBI Microfinance Pulse Vol II – June 2019

Table: 3

Table: 3 reflects

- a) Loan disbursement in terms of volume grew by 20% in FY 19 compared to FY 18
- b) NBFC-MFIs have sourced highest loans across all categories of lenders
- c) Banks witnessed highest growth at 32% in FY 19 compared to FY18

Disbursed Amount (in `Crore)

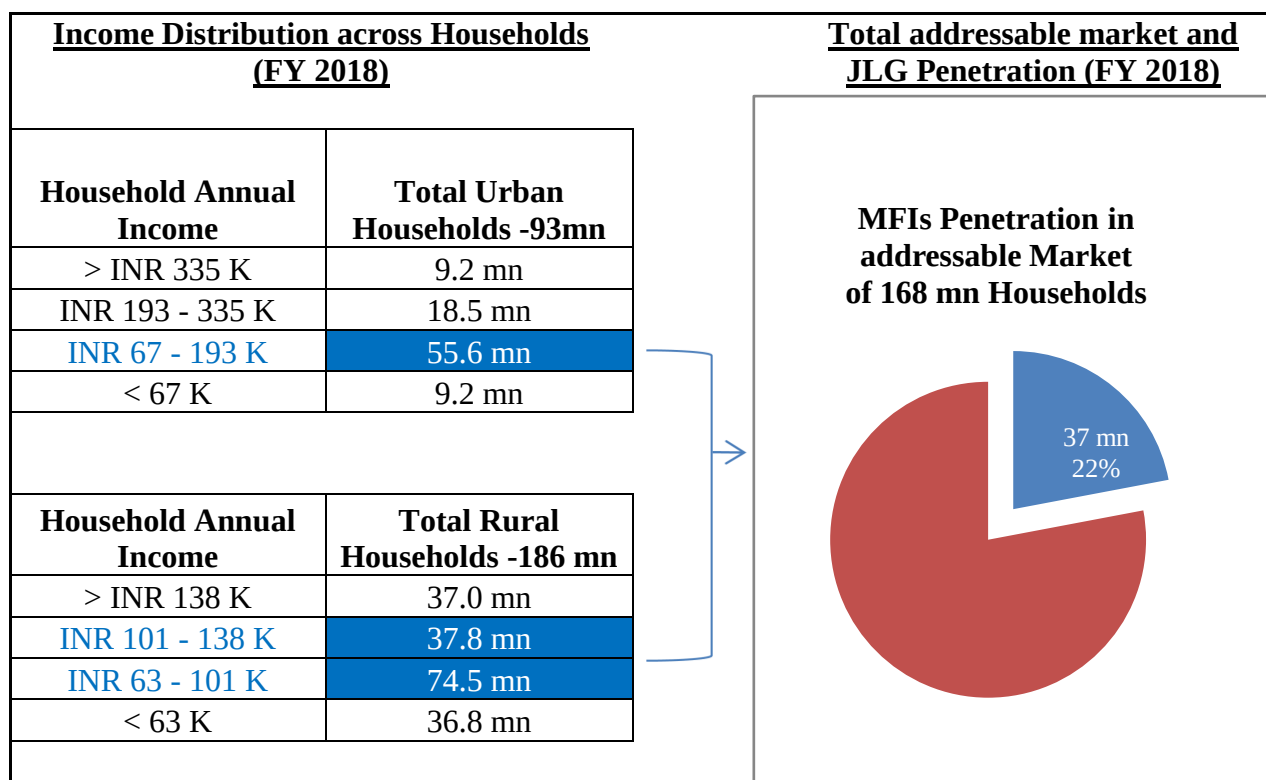
Particulars (as on March 31st)	FY 2016	FY 2017	FY 2018	FY 2019
Banks	34,859	44,225	54,107	78,596
SFBs	27,054	24,368	24,146	31,673
NBFC-MFIs	33,259	41,819	63,009	83,200
NBFCs	7,290	7,602	14,016	17,448
Not for Profit MFIs	2,729	1,508	1,933	2,157
Total Industry	105,191	119,522	157,211	213,074

Source: SIDBI Microfinance Pulse Vol II – June 2019

Table: 4

Table: 4 reflects

- Loan disbursal in terms of value grew by 36% in FY 19 compared to FY 18
- Banks witnessed highest growth at 45% from FY 18 to FY 19
- NBFC-MFIs witnessed growth at 32% from FY 18 to FY 19



Source: “Key Indicators of household consumption in India” National Sample Survey Office, KPMG Analysis

TABLE:5

The Table 5 clearly indicates the addressable segments in the urban and rural households who have the potential to improve their livelihood if supported. Out of these 168mn households the Micro-finance Institutions have been able to support 37 mn (22%) households. This definitely is a strong contribution from MFIs in the Indian economy,

Conclusion

NBFC-MFIs have been doing exceptionally well since 2011 with better reaching to more borrowers, more portfolio outstanding, number of loans and amount of disbursements and more importantly strictly complying under RBI guideline with its industry body MFIN.

The increase in the loan portfolio and the loan accounts reflects the enhanced needs and growing aspirations of microfinance customers across the country. According to Reserve Bank of India, Annual Report 2012, 21.92% people are below poverty line. So NBFC-MFIs along with banks, Small Finance Banks (SFBs), NBFCs have to tighten their belt and move ahead if India has to do well in Financial Inclusion.

The rate of interest charged to the borrowers is high compared to conventional loans. As RBI has removed the cap on 26% interest, the MFIs are charging more than 26% interest rate from the borrowers, which is a big burden for the poor people. This is an important factor which need to be looked at by RBI.

RBI needs to look at its monetary policy towards NBFC-MFIs, so that they can get cheaper funds from the banks, which can have a cascading effect on the borrowers. Cheaper funds lead to cheaper interest rate, which will lead to lesser liability as loan interest and lesser liability will lead to greater savings.

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