

# Performance of Microfinance Institutions in India

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**Abstract:** Microfinance can be described as an umbrella under which financial services including micro credit are provided to the low income group. The need for the unfolding of microfinance began in the developing nations more than thirty years ago. Microfinance refers to small scale financial services for both credits and deposits that are provided to people, who farm, operate small or micro enterprise where goods are produced, recycled, repaired, or traded. Microfinance playing an important role in developing the rural areas by providing loans to people at lower interest. The present research paper describes the role of Microfinance institutions in developing the conditions of people who are living in rural areas.

**Key words:** Microfinance, Rural, Interest and loan.

## INTRODUCTION

Microfinance can be described as an umbrella under which financial services including micro credit are provided to the low income group. The need for the unfolding of microfinance began in the developing nations more than thirty years ago. Microfinance refers to small scale financial services for both credits and deposits that are provided to people, who farm, operate small or micro enterprise where goods are produced, recycled, repaired, or traded.

The aim was to provide resources to help the poor to attend self sufficiency. They had

neither resourced nor employment opportunities to be financially independent, let alone meet the minimal consumptions needs.

Microfinance revolution in India as a powerful tool for poverty alleviation and women empowerment. Where institutional finance failed microfinance delivered, but the outreach is too small.

## Overview of microfinance in India

The micro finance sector in India has developed a successful and sustainable business model which has been able to overcome challenges traditionally faced by the financial services sector in servicing the lower income population.

In India, institutional credit agencies (banks) made an entry in rural areas initially to provide an alternative to the rural money lenders who provided credit support, but not without exploiting the rural poor. There are three main factors that count to the bringing up of Microfinance as a policy in India.

The first of these pivotal events was Indira Gandhi's bank nationalization<sup>1</sup> drive launched in 1969 which required commercial banks to open rural branches resulting in 15.2 increase in rural bank branches in India between 1973 and 1985, Today, India has over 32,000 rural branches of commercial banks and regional rural banks, 14,000 cooperative bank branches. The second national policy that has had a significant impact on the evolution of

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India's banking and financial system is the Integrated Rural Development program (IRDP) introduced in 1978 and designed to be 'a direct instrument for attacking India's rural poverty.' The last major event which impacted the financial and banking system in India was the liberalization of India's financial system in the 1990s characterized by a series of structural adjustments and financial policy reforms initiated by the Reserve Bank of India (RBI).

The microfinance business model in India typically generates a Return on Equity (ROE) OF between 20% and 30%, driven by financing from commercial banks, strong operating efficiency and high portfolio quality.

### **Micro Finance Service Providers**

The microfinance service providers include apex institutions like National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), and, Rashtriya Mahila Kosh (RMK). At the retail level, Commercial Banks, Regional Rural Banks, and, Cooperative banks provide microfinance services. Today, there are about 1,61,480 retail credit outlets of the formal banking sector in the rural areas comprising 13,000 branches of District level cooperative banks, over 15,480 branches of the Regional Rural Banks (RRBs) and over 38,400 rural and semi-urban branches of commercial banks besides almost 94,600 cooperatives credit societies at the village level. On an average, there is at least one retail credit outlet for about 4600 rural people. This physical reaching out to the far-flung areas of the country to provide savings, credit and other banking services to the rural society is an unparalleled achievement of the Indian banking system. An attempt is made here to deal with various aspects relating to emergence of private microfinance industry in the context of

prevailing legal and regulatory environment for private sector rural and microfinance operators.

### **Micro finance institutional structure in India**

The different organizations in this field can be classified as Mainstream and Alternative Micro finance Institutions (MFI).

Main stream micro finance institute structure includes NABARD, Small Industries Development bank of India (SIDBI), Housing development finance corporation (HDFC), commercial banks, Regional rural banks (RRB'S), the credit cooperative societies etc. are some of the mainstream financial institutions involved in extending micro finance.

The Alternative Micro Finance Institutions are the Institutions, which have come up to fill the gap between the demand and supply for microfinance. MFI's were recently defined by the Task Force as "those which provide thrift, credit and other financial services and products of very small amounts. Mainly to the poor, in rural, semi – urban or urban areas for enabling them to raise their income level and improve living standards."

Since last decade MFI (Micro finance Institutions) are playing vital role in strengthening the economy of the rural poor people. The Institutions are offering borrowings at lower interests. Government also encouraging the MFI's to strengthen their operations in rural areas and especially focusing on farmer's by issuing loan at lower interest for specific tenure. The Increase of the income levels of the rural people is influenced by the Micro finance institutions.

### **Micro finance sector in India**

Microfinance is an economic development tool whose objective is to assist the Poor to work their way out of poverty. It covers a range of services which include, in addition to the provision of credit, may other services such as savings, insurance, money transfers. Counseling, etc.

The provision of credit to the Microfinance sector is based on the following postulates

1. It addresses the concerns of poverty alleviation by enabling the poor to work their way out of poverty.
2. It provides credit to the section of society that is unable to obtain credit at reasonable rates from traditional sources.
3. It enables women's empowerment by routing credit directly to women, thereby enhancing their status within their families, the community and society at large.
4. Easy access to credit is more important for the poor than cheaper credit which might involve lengthy bureaucratic procedures and delays.
5. The poor are often not in position to offer collateral to secure the credit.
6. Given the imperfect market in which the sector operates and the small size of individual loans, high transaction costs are unavoidable.

### **The players in Microfinance Sector**

The players in the Microfinance sector can be classified as falling into three main groups.

1. The SHG – Bank linkage Model accounting for about 58% of the outstanding loan portfolio.
2. Non – Banking Finance Companies accounting for about 34% of the outstanding loan portfolio.
3. Others including trust, Societies, etc. accounting for the balance 8% of the outstanding loan portfolio. Primary

Agricultural Co-operative Societies numbering 95,663 covering every village in the country.

### **Important features of credit for microfinance**

The essential feature of credit for Microfinance which have evolved are as under

- The borrowers are low- income groups.
- The loans are for small amounts.
- The loans are without collateral
- The loans are generally taken for income-generating activities, although loans are also provided for consumption, housing and other purposes.
- The tenure of loans is short.

### **OBJECTIVES OF STUDY**

1. To examine the trends and pattern of Micro finance institutions in India.
2. To estimate the demand and supply of credit in rural areas.
3. To examine the Impact of Micro finance institutions in rural Areas.
4. To suggest measures for making Micro Fiancé Institutions more efficient in credit.

### **REVIEW OF LITERATURE**

A Literature review is a survey and discussion of the literature in a given area of study. It is concise overview of what has been studied, argued, and established about a topic, and it is usually organized chronologically or thematically. A literature review surveys scholarly articles, books and other sources relevant to particular review surveys scholarly articles, books and other sources relevant to particular issue, area or research, or theory, providing a description, summary and critical evaluation of each work.

Mr. Brij Mohan<sup>2</sup> who is former Executive director, SIDBI speaks about the future of micro credit in agricultural sector in India. In his report he concluded that Micro finance institutes are playing instrumental role in formulating the financial policies relating to agricultural sectors and he also suggest that the Micro finance institutes focused on credit policies to offer better services to farmers in rural India.

Srinivasan santhanam<sup>3</sup> in his report, he suggest commercial banks in India has to Increase the amount of loans Issuing to the Self Help Groups (SHG's) to expand the banking operations as well as strengthen the living conditions of rural people. Shri Kshethra Dharmasthala Rural Development Project (SKDRDP)<sup>4</sup> in South India is a prime example of the vital role a well-run microfinance organization can play in meeting the Poor's energy needs.

Micro credit seeks to promote business growth and improve well-being by expanding access to credit. Micro credit works broadly through risk management and investment at the household level, rather than directly through the targeted businesses.

Dean Karlan, Yale University, IPA, Financial Access Initiative, MIT Jameel Poverty Action Lab July 2009

Abhijit Banerjee<sup>5</sup> in his report he emphasizes on micro credit operations in Hyderabad, India's fifth-largest city. Spandana choose 104 areas of the city to expand into eventually, rejecting some districts as having too many construction workers more than 6,000 households between August 2007 and April 2008, and

<sup>2</sup> Brij mohan report submitted to SIDBI.

<sup>3</sup> Srinivasan santhanam report on SHG relating to micro finance, 2009.

<sup>4</sup> Report submitted by SKDRDP 2010.

<sup>5</sup> Abhijit Banerjee, Indian Centre for Micro finance , Sapandana Otober 2009.

he concluded that the government and institutions needs take initiatives to strengthen the operations in rural and urban areas to improve the income status of lower income people.

A self – help cooperative<sup>6</sup> is an autonomous association of people united voluntarily to meet their common needs and aspirations through a jointly owned and democratically controlled enterprise. The common needs members from cooperative group is fulfilling by providing financial assistance from the Micro Finance Institutions especially in rural areas.

### Analysis of Study:

There are conflicting estimates regarding the total demand for microfinance in the country and the extent of penetration. However, all these estimates confirm the fact that the present amount of microfinance provided by both SHGs and MFI is a small portion of the total demand.

According to 'Microfinance India-state of the Sector report 2010' the following analysis is drawn from the following interpretation.

For this purpose a published Microfinance penetration among poor Index (MPPI) is comparing with the Proportionate share of region.

Table 1: Comparison of MPPI with respect to region

Region	MPPI
North	0.41
North East	0.71
East	0.74
Central	0.32
West	0.81
South	3.40

From the above table it is clearly notifying that in South region is far ahead as compare

<sup>6</sup> A report from self – help Cooperative society organized under Co – operative act 2001.

to other regions in India. The Microfinance institutions functioning very Accurate in south region. But the central and north regions are in backward in utilizing the services of microfinance institutions.

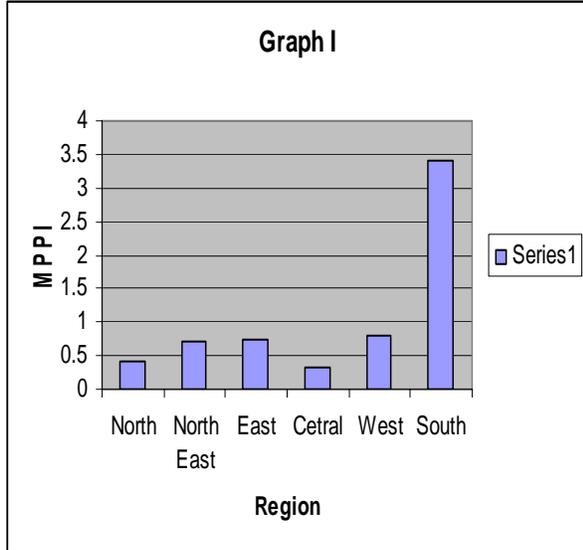
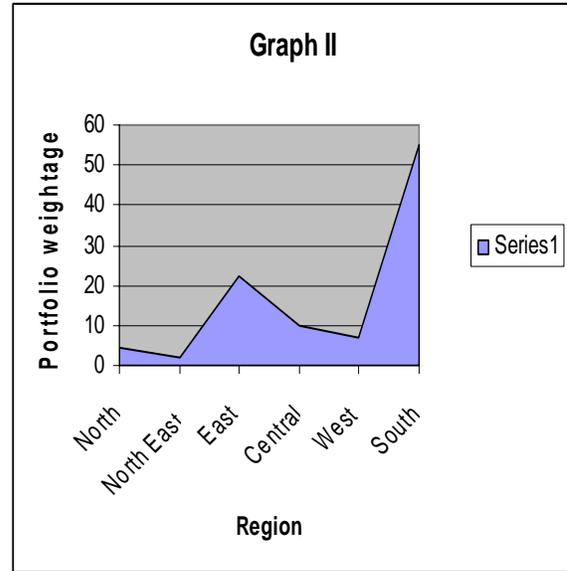


Table 2: Comparison with respect to Portfolio.

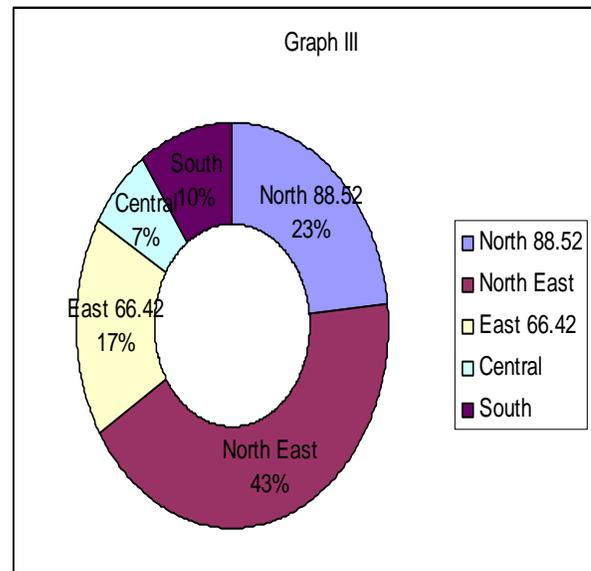
Region	% of Portfolio
North	4.27
North East	1.75
East	22.53
Central	9.88
West	6.75
South	54.81



The above table clearly depicting that the overall volume of the microfinance institutions is very high in south regions as compared to other regions.

Table 3: Comparison with respect to Growth

Region	% Growth
North	88.52
North East	163.62
East	66.42
Central	25.81
South	37.09



From the above analysis report it is clearly identifying the recent growth in North East is very high and the growth in Central India is very low.

**Conclusion:** The functioning of Microfinance institutions in India is playing an important role in rural areas since last two decades. The growth of the MFI's in South India is very high as compared to other parts of India. The central government and RBI should take necessary measurements to increase the performance of MFI's in Other parts of India especially North and Central India. The concern state governments also take necessary measurements to create awareness among people to use the services of Microfinance institutions to strengthen their Economical status and improving their lively wood.

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