

# MICROFINANCE IN INDIA: ISSUES AND CHALLENGES

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## ABSTRACT

*We are now talking about the development and growth of Indian economy, but this cannot be done without the participation of poor and small entrepreneurs. Microfinance can play a vital role in providing financial services to the poor and deprived segment of our economy. It refers to the provision of financial services: small savings, credit & insurance services to the socially & economically disadvantaged segments of the society. It is emerging as a powerful tool for poverty alleviation in India. It has occupied centre stage as a promising conduit for extending financial services to unbanked sections of population. This paper is an attempt to find out the challenges and issues relating to microfinance. The prospect of Micro-Finance is dominated by SHGs (Self Help Groups) - Banks linkage Program. Its main aim is to provide a cost effective mechanism for providing financial services to the poor. This paper discovers the prevailing gap in functioning of MFIs such as high interest rates, customer overlapping & duplication, dropouts and mitigation of group members, low financial literacy, inability of the members to generate sufficient fund & grey areas in regulations. All these are the clear syndromes that this sector requires greater scrutiny and strict regulations. Finally paper concludes with practicable suggestions to overcome the issues and challenges associated with microfinance in India.*

**Key Words:** *Microfinance, Self Help Groups (SHGs), MFIs*

## I. INTRODUCTION

Financial sector policies in India have long been driven by the objective of increasing financial inclusion, but the goal of universal inclusion is still a distant dream. For a financial system to be truly inclusive, it should meet the needs of everyone who can fruitfully use financial services, including the poor. Government of India has taken various steps for alleviating poverty since Independence. However, in spite of the various efforts, almost 27 percent of total population in India still continues to be below the poverty line. For the developing countries like India, microfinance has come as a breakthrough in the philosophy and practices of poverty eradication, economic empowerment and inclusive growth. Microfinance is considered to be revolutionary because it aims at servicing the poorest of the poor, who were up till now considered unfit for financing of any kind except charity. Microfinance is a general term to describe financial services to low-income individuals or to those who do not have access to typical banking services. Microfinance is also the idea that low-income individuals are capable of lifting themselves out of poverty if given access to financial services.

## **II. OBJECTIVES OF THE STUDY**

- To define the meaning of microfinance, microfinance institutions and SHG-BLP(Self help group-Bank Linkage Programme).
- To examine the glaring issues and challenges of microfinance in India.
- To explore the strategies to be implemented to overcome issues and challenges.

## **III. MICROFINANCE**

**Microfinance** is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services due to the high transaction costs associated with serving these client categories. Microfinance can play a vital role in providing financial services to the poor and deprived segment of our economy. Microfinance is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers. Microfinance scheme provides a wide range of financial services to people who have little or nothing in the way of traditional collateral. It helps them to build up assets, survive crises and to establish small business to come out of poverty. The microfinance sector consistently focuses on understanding the needs of the poor and on devising better ways of delivering services in line with their requirements, developing the most efficient and effective mechanisms to deliver finance to the poor.

## **IV. MICROFINANCE INSTITUTIONS**

A microfinance institution is an organization that offers financial services to low income populations. The Micro Finance Institutions (MFIs) access financial resources from the Banks and other mainstream Financial Institutions and provide financial and support services to the poor. Among the Indian institutions offering microfinance services, there are Non-Government Organizations (NGOs), Private Foundations/Trusts, Cooperatives, Commercial Banks, Regional Rural Banks (RRBs), Local Area Banks (LABS) as well as specialized Non-Banking Financial Institutions (NBFCs). Currently India is considered to be the largest emerging market for microfinance. It has been growing in India at a steady pace over the past decade.

The reasons for existence of separate institutions i.e. MFIs for offering micro finance are as follows:

- High transaction cost – generally micro credit fall below the break-even point of providing loans by banks.
- Loans are generally taken for very short duration periods.
- High frequency of repayment of installments and higher rate of default.
- Absence of collaterals – poor are not in a state to offer collaterals to secure the credit .

## **V. SHG - BANK LINKAGE PROGRAMME**

An SHG both by definition and in practice is a group of individual members who by free association come together for a common collective purpose. That is they are homogeneous and have certain pre group social binding factors. In the context of micro-finance, SHG are formed around the theme of savings and credit. In practice SHG comprise individual members known to each other. The SHG – Bank Linkage Programme started

as an Action Research Project in 1989. In 1992, the findings led to the setting up of a Pilot Project. The pilot project was designed as a partnership model between three agencies, viz., the SHGs, banks and Non Governmental Organizations (NGOs). The project objective was to facilitate access of the poor to formal credit institutions. The pilot project envisaged banks to lend to the SHGs without collateral on the principle of trust-banking. The SHG-Bank Linkage Model has emerged as a dominant model in terms of number of borrowers and loans outstanding. This model is flexible, independence creating, and imparts freedom of saving and borrowing according to the requirements of group members. Due to widespread rural bank branch network, the SHG-BLM is very suitable to the Indian context. Microfinance movement started in India with the introduction of SHG-Bank Linkage Programme (SHG BLP). The programme uses SHGs as an intermediation between the banks and the rural poor to help in reducing transaction costs for both the banks and the rural clients.

The impact of the programme is discussed below:

- i. microfinance has reduced the incidence of poverty through increase in income, enabled the poor to build assets and thereby reduce their vulnerability.
- ii. It has enabled households that have access to it to spend more on education than non client households. Families participating in the programme have reported better school attendance and lower dropout rates.
- iii. It has empowered women by enhancing their contribution to household income, increasing the value of their assets and generally by giving them better control over decisions that affect their lives.
- iv. In certain areas it has reduced child mortality, improved maternal health and the ability of the poor to combat disease through better nutrition, housing and health - especially among women and children.
- v. It has contributed to a reduced dependency on informal money lenders and other non institutional sources.
- vi. It has facilitated significant research into the provision of financial services for the poor and helped in building “capacity” at the SHG level.

## VI. CHALLENGES FACED BY MICRO FINANCE

There are over 10,000 microfinance institutions serving in excess of 150m customers, 100m of them being the poorest families. Microfinance is gathering momentum to become a significant force in India. Some challenges faced by micro finance in India are:

**Financial illiteracy:** One the major challenge in India towards the growth of the microfinance sector i.e. illiteracy of the people. This makes it difficult in creating awareness of microfinance and even more difficult to serve them as microfinance clients.

**Lack of information** There are various sources of credit information in India, but none of these focuses on small, rural borrowers. Credit information on such borrowers is difficult to obtain because the majority of the rural poor rely on moneylenders and other informal lenders, and it is not in the interest of such lenders to pass on a borrower’s good credit repayment record to other providers of finance.

**Inability to generate funds:** MFIs have inability to raise sufficient fund in the microfinance sector which is again an important concerning challenge. Through NBFCs are able to raise funds through private equity investment because of the for profit motive, such MFIs are restricted from taking public deposits.

**Heavy dependence on banks & FIS:** MIF's are dependent on borrowing from banks & FIS. For most of the MFI's funding sources are restricted to private banks & apex MFI's. In these available banks funds are typically short term i.e. maximum 2 years period. Also there is a tendency among some lending banks to sanction and disburse loans to MFI,s around the end of the accounting year in pursuit of their targets.

**Weak governance:** Many MFI's are not willing to convert to a corporate structure; hence they trend to remain closed to transparency and improved governance, thus unable to attract capital. MFI's also facing a challenge to strike a balance between social and business goals. Managements need to adapt business models based on changing scenarios & increased transparency; this will enable attracting capital infusion and private equity funds.

**Interest Rate:** MFIs are charging very high interest rates, which the poor find difficult to pay. MFIs are private institutions and therefore require being economically sustainable. They do not get any subsidized credit for their lending activities and that is why they need to recover their operational costs from borrowers

**Regional Imbalances:** There is unequal geographical growth of Microfinance institutions and SHGs in India. About 60% of the total SHG credit linkages in the country are concentrated in the Southern States. However, in States which have a larger share of the poor, the coverage is comparatively low. Main reason for this is the state government support, NGO concentration and public awareness

## VII. SUGGESTIONS

Although the microfinance sector is plagued by a number of problems but there is a way out for the problems faced by this sector. Improvements are required from the side of government, Microfinance institutions and individual clients. Some of the suggestions are:

1. The concept of Micro Finance is still new in India. Not many people are aware the Micro Finance Industry. So apart from Government programmers, we the people should stand and create the awareness about the Micro Finance.
2. Microfinance programmes and group formation should be handled by trained personnel in a professional manner.
3. Leading banks and industry developments must be taken into consideration for district-wise and block-wise economic opportunities and resource mapping.
4. There are many people who are still below the poverty line, so there is a huge demand for MFIs in India with proper rules and regulations.
5. There is huge demand and supply gap, in money demand by the poor and supply by the MFIs. So there need to be an activate participation by the Pvt. Sector in this Industry.
6. One strict recommendation is that there should not over involvement of the Government in MFIs, because it will stymie the growth and prevent the others MFIs to enter.

## VIII. CONCLUSION

This study concludes that microfinance is very necessary in India to achieve financial inclusion of the poor in the rural and urban areas. Lending to the poor population if handled in an effective manner it can be a miracle

for the development of the country and alleviation of Poverty. If government and MFIs act together then microcredit can play a great role in poverty alleviation. The challenging issue in microfinance helps to reduce the financial problems faced by poor people. Inability of MFIs in getting sufficient funds is a major challenge in the microfinance growth and so these institutions should look for alternative source of funds. The impact of microfinance is appreciable in bringing confidence, courage skill development among poor people. Thus external factors such as microfinance institutions are needed to help fix these problems.

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