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Financial Inclusion and Microfinance

Chapter Objectives

This chapter will enable you to develop an understanding of the following:

1 *Financial inclusion*
2 *Microfinance*
3 *Financial inclusion*

INTRODUCTION TO FINANCIAL INCLUSION

The banks were nationalized with an objective to cover a large part of the population under banking services. Even after more than 35 years of nationalization, more than 40 per cent of the adult population in India has no access to formal banking and financial services. This financial exclusion could be on the grounds that the individual has either no savings/assets and hence, no savings/current account in the bank. Besides, he also may not have access to any financial advice and perceives the cost of the financial services as not affordable.

Several studies have revealed the extent of financial exclusion in India. Some of the studies are cited as follows:

1. According to the Rural Financial Access Survey, 2003, conducted by the World Bank and the National Council of Applied Economic Research, only 21 per cent of the rural households have access to formal credit and 42 per cent rural households have access to saving deposits in the states of Andhra Pradesh and Uttar Pradesh. Among the rural households, it is the poorer households which have no access to financial services. Moreover, 70 per cent of marginal farmers do not have a bank account and 87 per cent have no access to formal credit. The reasons cited by the survey include cumbersome procedures for opening an account or seeking a loan and inability of the borrower to provide a collateral with a clear title coupled with unstable/irregular income.
2. The All India Rural Debt and Investment Survey (AIDIS), 2002, showed that 111.5 million households had no access to formal credit and 17 million households were indebted to moneylenders. It also revealed that lower the asset class or income, higher the degree of exclusion.
3. The Invest India Incomes and Savings Survey (2007) showed that 32.8 per cent of households had borrowed from institutional sources and 67.2 per cent had borrowed from non-institutional sources. It also found that 70 per cent of earners in the annual income bracket of more than ₹400,000 borrowed from institutional sources as compared with only 27.5 per cent in the case of earners in the income bracket of less than ₹50,000.

   In India, the financially excluded sections comprise largely marginal farmers, landless labourers, self-employed and unorganized-sector enterprises, urban-slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women. These sections have no access to basic banking services like payment services, savings or loans.
4. The Committee on Financial Inclusion (2008) observed that in India 51.4 per cent of farmer households are financially excluded from both formal/informal sources and 73 per cent of farmer households do not access formal sources of credit. Exclusion is most acute in Central, Eastern and North-Eastern regions with 64 per cent of all financially excluded farmer households.

Financial exclusion leads to loss of opportunities of growth for an individual, which, in turn, leads to loss of output for an economy and a reduction in the societal welfare. The financially excluded sections turn to the informal sector to meet their medical and social obligations and get trapped into a vicious circle of poverty and social exclusion. Research has found that countries with a high level of income inequality tend to have higher levels of financial exclusion.

Evidences of Financial Exclusion

The Indian economy is one of the fastest growing economies of the world. But this economic growth is skewed as all the sections of the society have not benefited from this growth process. When certain sections of the society are bypassed, the sustainability of the growth process is threatened. The evidences are as follows:

1. **A large number of people below the poverty line with no access to financial services:** Banks opened a large number of branches in the rural areas, implemented specific poverty-alleviation programmes and encouraged self-employment through cheap subsidized credit for decades, but through inappropriate policies, services and loan products. The loan products of large sizes did not suit the needs of the large number of poor. What the poor really needed was a better access to these services and products rather than a subsidized credit.
2. **The average employment rate declined from 2.84 per cent during 1980–90 to 2.49 per cent in 2005:** There has been a substantial decline in the rural employment on account of commercialization of agriculture and technology intensification. Banks' focus was centered on the credit delivery for the agriculture to fulfil the priority sector-lending norms laid down by the Reserve Bank. These policies and practices did not encourage them to finance micro-enterprises and create opportunities for self-employment.
3. **Banks' focus on commercial objectives with emphasis on profitability:** In the late 1990s, the objective of the Reserve Bank of India (RBI) was to strengthen the banking system. With the introduction of prudential norms, the focus was on quality lending and viable accounts which implied a tendency towards exclusion.
4. **The success of microfinance in rural India:** The RBI took an initiative to promote financial inclusion—to include those who have been excluded from banking services with a view to empowering them.

Magnitude of Financial Exclusion

- 500 million unbanked population in India
- Out of more than 6,00,000 rural habitations, only around 32,000 have a commercial bank branch.
- 99 blocks in the country not having a single bank branch. Of these, 86 are in the North-East with some blocks having population of less than 10,000.

Definition of Financial Inclusion

The Asian Development Bank has defined financial inclusion as 'provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their micro-enterprises.'

The Committee on Financial Inclusion has defined financial inclusion 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.'

Financial Inclusion Includes

- Access to a No-frills account
- Access to credit
- Access to insurance and remittance facilities
- Credit counselling
- Financial education/literacy

Benefits of Financial Inclusion

1. Financial inclusion is an avenue for bringing the savings of the poor into the formal financial intermediation system.
2. Large number of low-cost deposits help banks manage both liquidity risks and asset-liability mismatches.
3. Financial inclusion helps transfer payments such as social security, national rural employment guarantee programme (NREGA) wages into the bank accounts of beneficiaries through the 'electronic benefit transfer' (EBT) method.
4. It provides opportunities to the poor to build savings, make investments and avail credit.
5. It helps the poor insure themselves against income shocks and equip them to meet emergencies such as illness or loss of employment.

Policy Initiatives for Inclusive Finance

- Nationalization of banks
- Lead bank scheme
- Priority sector lending
- Setting up of RRBs in 1975
- Poverty alleviation programmes in 1980s
- Microfinance-SHG movement in 1990s
- Simplification of KYC norms
- Issue of GCC
- BC/BF model
- Priority sector redefined

Process of Financial Inclusion

Financial inclusion is to be undertaken in three steps:

1. Providing access to financial products and services.
2. Availability of financial products and services in a fair and equitable manner.
3. Credit counselling which includes providing sound services to arrest deterioration of incomes, restructuring of debt solution to overcome debt burden and improve money-management skills.

Various Initiatives Undertaken for Financial Inclusion

1. In 1992, the SHG–bank linkage programme and in 1998, Kisan Credit Cards (KCCs) for providing credit to farmers were introduced by NABARD, with policy support from the RBI. Under the SHG–bank linkage programme, banks provide the resources, while the non-government organi-

- Under the Business Facilitator Model, banks may use the services of intermediaries such as:
  (a) Non-Governmental Organisations (NGOs)/Self Help Groups (SHGs)
  (b) Farmers Clubs
  (c) Cooperatives
  (d) Community based organizations
  (e) IT enabled rural outlets of corporate entities
  (f) Post Offices
  (g) Insurance agents
  (h) Well functioning Panchayats
  (i) Village Knowledge Centres
  (j) Agri Clinics
  (k) Agri Business Centres
  (l) Krishi Vigyan Kendras
  (m) Khadi and Village Industries Commission (KVIC)/Khadi and Village Industries Board (KVIB) units
- Business correspondents and facilitators support the bank by extending nonfinancial services to the poor. They function as 'pass through' agents.
- FINO (Financial Information Network and Operations Limited) Fintech Foundation, a section 25 company under the Indian Companies Act of 1956, provides business correspondent services to banks. It is a multi-bank promoted company.

Challenges to the BC Model

- High maintenance costs.
- Small size of transactions.
- Lack of electricity and telecommunication access.

zations (NGOs) act as agencies to organize the poor, build their capacities and facilitate the process of empowering them. In 1998, those SHGs that were engaged in promoting the saving habits among their members were made eligible to open savings bank accounts.

2. In April 2005, 'financial inclusion' was explicitly made as a major policy objective and in November 2005, banks were advised to make available a basic banking 'no frills' account with low or nil minimum balances through simplified know-your-customer (KYC) procedures as well as charges to expand the outreach of such accounts to vast sections of the population. The KYC procedure for opening accounts was simplified for those accounts with balances not exceeding ₹50,000 and credit limits not exceeding ₹100,000 in a year. The simplified procedure allowed an introduction by a customer on whom the full KYC drill had already been done. The customer is allowed 5–10 transactions, free of cost, and an ATM facility. NGOs and MFIs (microfinance institutions) can act as agents to help open accounts. Banks were also asked to offer a small overdraft/general credit card (GCC), not exceeding ₹25,000, to their customers at their rural and semi-urban branches. Under GCC, banks do not insist for collateral; and based on the assessment of household cash flows, the limits are sanctioned. Interest rate on the facility is completely deregulated. 50 per cent of GCC loans are treated as priority-sector lending.
3. In January 2006, the RBI permitted banks to utilize the services of NGOs/SHGs, MFIs (other than NBFCs) and other civil-society organizations, as intermediaries, for providing financial and banking services through the use of a **business facilitator (BF) and business correspondent (BC) models.**

   Banks use BFs for (i) identification of borrowers and fitment of activities; (ii) collection and preliminary processing of loan applications including verification of primary information/data; (iii) creating awareness about savings and other products and education and advice on managing money and debt counselling; (iv) processing and submission of applications to banks; (v) promotion and nurturing Self-help Groups/Joint-liability Groups; (vi) post-sanction monitoring; (vii) monitoring and handholding of Self-help Groups/Joint-liability Groups/Credit Groups/others; and (viii) follow-up for recovery. Banks may use intermediaries, such as, NGOs/Farmers' Clubs, cooperatives, community-based organizations, IT-enabled rural outlets of corporate entities, post offices, insurance agents, well-functioning panchayats, village knowledge centres, agri clinics/agri business centres, krishi vigyan kendras and KVIC/KVIB units, for providing facilitation services.

   The role of the business correspondent (BC) is to disburse small loans, recover principal and interest, collect saving deposits, deliver small-amount remittances, make pension payments and wage payments under National Rural Employment Guarantee (NREG) Scheme and sell micro-insurance, mutual funds, pension funds and other third-party products on behalf of the bank. He earns commission for undertaking these activities. He uses a finger-print scanner, an identifier, a mobile and a printer to process the payments. The beneficiaries hold smartcards with the photographs and images of their finger prints preloaded. The chip gets activated and connected with the bank server, using a dial-up or mobile phone. The BC may carry cash physically to make payments. The distance between the place of business of the BC and the branch should not exceed the criterion of 30 kms in rural, semi-urban and urban areas and 5 kms in metropolitan centres. RRBs can provide an intermediate brick and mortar structure (Ultra Small Branch) between the present base branch and BC locations so as to provide support to a cluster of BC units at a reasonable distance. The Ultra Small Branches could be satellite offices or regular branches and may be set up between the base branch and BC locations so as to provide support to about 8–10 BC units at a reasonable distance of 3–4 kilometers. They could be either set up newly or by conversion of the BC outlets. Ultra Small Branches should have minimum infrastructure such as a Core Banking Solution (CBS) terminal linked to a pass book printer and a safe for cash retention for operating large customer transactions and be managed full time by bank officers/employees. A BC or a BF is generally appointed for a district by the bank, and is either a part of the bank or the MFI, usually an NGO, it has partnered with. Being a familiar face for the villagers, he is just like a mobile pocket ATM enabling anytime, anywhere banking. For banks, this branchless banking extends the distribution of financial service to rural people at low cost, increases access to cheap savings and enhances the scope for distribution of other services such as crop loans and micro-insurance. Banks are permitted to appoint NGOs/MFIs to set up under Societies/Trust Acts, Societies registered under Mutually Aided Cooperative Societies Acts or the Cooperative Societies Acts of States, Section 25 companies, registered NBFCs not accepting public deposits and post offices to act as BCs. The goal of the RBI is to have at least one BC in every village.

   In April 2008, banks were permitted to engage retired bank employees, ex-servicemen and government employees as BCs, subject to appropriate due diligence. Section-25 companies, NBFCs and post offices acting as BCs can appoint sub-agents while individuals appointed as BCs cannot appoint sub-agents.

RRBs may engage the following individuals/entities as BCs:

(a) Individuals like retired bank employees, retired teachers, retired government employees and ex-servicemen, individual owners of 'kirana'/medical/Fair Price shops, individual Public Call Office (PCO) operators, agents of Small Savings schemes of Government of India/Insurance Companies, individuals who own petrol pumps, authorized functionaries of well-run Self Help Groups (SHGs) which are linked to banks, any other individual including those operating Common Service Centres (CSCs);
(b) NGOs/MFIs set up under Societies/Trust Acts and Section 25 Companies;
(c) Cooperative Societies registered under Mutually Aided Cooperative Societies Acts/Cooperative Societies Acts of States/Multi State Cooperative Societies Act;
(d) Post Offices;
(e) Companies registered under the Indian Companies Act, 1956 with large and widespread retail outlets, other than Non- Banking Financial Companies (NBFCs); and
(f) Non Deposit taking NBFCs (NBFCs-ND).

NBFCs-ND may be engaged as BCs, subject to the following conditions:

(i) It should be ensured that there is no comingling of bank funds and those of the NBFC-ND appointed as BC;
(ii) There should be a specific contractual arrangement between the bank and the NBFC-ND to ensure that all possible conflicts of interest are adequately taken care of;
(iii) RRBs should ensure that the NBFC-ND does not adopt any restrictive practice such as offering savings or remittance functions only to its own customers and forced bundling of services offered by the NBFC-ND and the bank does not take place.

Many public-sector banks have already taken initiatives towards financial inclusion. The Union Bank of India has launched 'village knowledge centres' wherein the bank's staff act as relationship managers, liasing between local authorities and farmers, facilitating the opening of accounts and ensuring that the credit is provided to the needy poor. Andhra Bank has already covered 2,80,000 families under its Srikakulam district project. It not only assists the families in opening a bank account, but also issues them general-purpose credit cards. The RBI launched the 'bank-in-a-box' model in Andhra Pradesh, in collaboration with the Union Bank of India and Corporation Bank. In this project, a local BC opens and maintains accounts for the rural population. He is responsible for collecting savings and giving loans. The number of deposit accounts has exceeded the loan accounts in this model.

4. Based on the recommendations of the C. Rangarajan Committee Report on Financial Inclusion, the government has set up two funds—Financial Inclusion Fund (FIF) for supporting developmental and promotional activities for ensuring financial inclusion and the Financial Inclusion Technology Fund (FITF) for enhancing investment in Information Communication Technology (ICT) for promoting financial inclusion. Each of the funds has an overall corpus of ₹500 Crore.

Conclusion

Financial exclusion is a concern of both developed as well as developing countries. The move towards inclusive growth is a big challenge for the financial system. Banks and financial institutions need to re-orient their strategies to increase their effective reach. Financial literacy and awareness about financial products in rural areas also need to be taken up, especially by regional rural banks. In saturated markets, it is the bottom of the pyramid which provides more opportunities if properly tapped. Extensive use of technology can help reduce operating costs of small accounts which are a major hindrance to expansion of banking services. Technology and participation with various voluntary organizations can be facilitators in the promotion of financial inclusion.

Thrust on

- Spreading Financial Literacy.
- Spreading awareness about micro-products in rural areas.
- Pro-active participation of banks and technology players.

MICROFINANCE

A large section of the Indian population is not covered by the formal financial system even after three-and-a-half decades of nationalization of banks. The government nationalized and expanded the banking system to enlarge its coverage to as large a segment of the population of the country, through the use of targeted, low-priced loans. The poor were given subsidized credit so as to reduce their dependence on the informal sector, which charged high-interest rates in the range of 25–40 per cent. The rural cooperative banks and the regional rural banks were set up to cater to the financial needs of the rural poor. Also, the commercial banks are required to ensure that 40 per cent of the total credit is allocated to the priority sectors. In the race to achieve the quantitative targets, the bankers' lost sight of the qualitative aspects of lending which resulted in high-loan defaults and a belief that poor are not really bankable. For the banking institutions, the transaction cost inherent in servicing small loans to a large number of borrowers and the perceived risk cost in the absence of appropriate risk-management system are barriers to financial inclusion. Thus, for the banking institutions, lending to the poor was a social obligation and not a viable commercial activity. This widened the gap between the demand and supply of credit to weaker sections in the rural areas. Thus, a large section of the population, particularly in rural areas, remains excluded with no access to formal financial services.

An alternative delivery mechanism, for meeting the requirements of the poor known as microfinance, came into existence.

Microfinance: The Paradigm

In 1976, Dr Mohammed Yunus, professor of Economics in Chittagong University, Bangladesh, came up with the concept of lending to groups of poor women. This group was loaned money without any collateral, but with higher interest rates of 20–24 per cent. If any one member defaulted, the group was denied access to further credit. This joint liability put a social pressure which produced a very high repayment rate of 98 per cent. The success of this pilot project inspired him to set up a Grameen Bank for providing banking services to the poor.

In the Grameen Bank model, members of the group are also the owners of the bank. The group normally consists of five members and the liability to repay the loan lies with the individual. The loan is given directly on the basis of trust and no agreement or document is required. The success of Grameen Bank proved that the poor needed access to financial services rather than the cheap subsidized credit. This pioneering experiment came to be later known as 'microfinance' for the poor. The Grameen Bank lends US $30 million a month to 1.8 million needy borrowers. Dr Mohammed Yunus and the Grameen Bank were awarded the Noble Peace Prize in 2006 'for their efforts to create economic and social development from below.' The success of this concept inspired many to set up similar projects across the globe. Today, there are over 7,000 microfinance institutions across the globe, serving 16 million poor households in developing countries.

Microfinance is the provision of financial services to the poor. These financial services may take the form of micro-savings, micro-credit and micro-insurance. Microfinance is also referred to as 'the alternate commercial sector targeting the poor.' The Task Force on Supportive Policy and Regulatory Framework for Microfinance (NABARD), 1999, defines microfinance as 'provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards.' Microfinance is a holistic concept—it includes not only micro-credit but also support services such as savings, insurance, payments, market and technical assistance, and capacity building. The clients of microfinance are landless labourers engaged in agriculture, mining and construction; small and marginal farmers; rural artisans and weavers; self-employed in urban informal sector; self-employed in non-farm activities; and women.

Microfinance in India evolved to fill the gaps created by the formal banking institutions. The microfinance movement had already begun in India in the 1970s. Shri Mahila SEWA (Self-Employed Women's Association) Sahakari Bank in Ahmedabad (Gujarat) and Working Women's Forum in Tamil Nadu were the pioneers. The SEWA Bank was set up in 1974 as an Urban Cooperative Bank providing banking services to the poor self-employed women. It has deposits of over ₹100 crore, mobilized from nearly 2,50,000 women. It is the biggest poor women's bank in the world and the first microfinance institution (MFI) to be set up in India. In the 1980s, many NGOs, interested in social-development, were involved in forming small informal self-help groups (SHGs) engaged in micro-activities. These SHGs were successful in effectively meeting the immediate needs of their members. They had potential of growth but their major constraint was finance, that is, getting big loans to finance their activities. Realizing the potential of these SHGs through research studies and other initiatives, NABARD designed the SHG–bank linkage concept—wherein the SHGs are linked with banks for funds. Looking at the success of NGOs and NABARD, several microfinance institutions came into existence to help the rural and urban poor, particularly, women.

NGOs and SHGs

Non-government organizations (NGOs) are the key players in the microfinance sector. An NGO is a voluntary organization established to undertake social intermediation like organizing SHGs of micro-entrepreneurs and entrusting them to banks for credit linkage or financial intermediation, like borrowing bulk funds from banks for on-lending to SHGs. NGOs are the promoters of the concept of SHGs. Professional Assistance for Development Action and Mysore Resettlement and Development Agency (MYRADA) were the pioneers to promote the concept of SHGs. NGOs have emerged as an effective change agents by organizing and promoting SHGs and facilitating their linkage with banks. They conduct workshops, seminars, and training programmes to create awareness among SHGs.

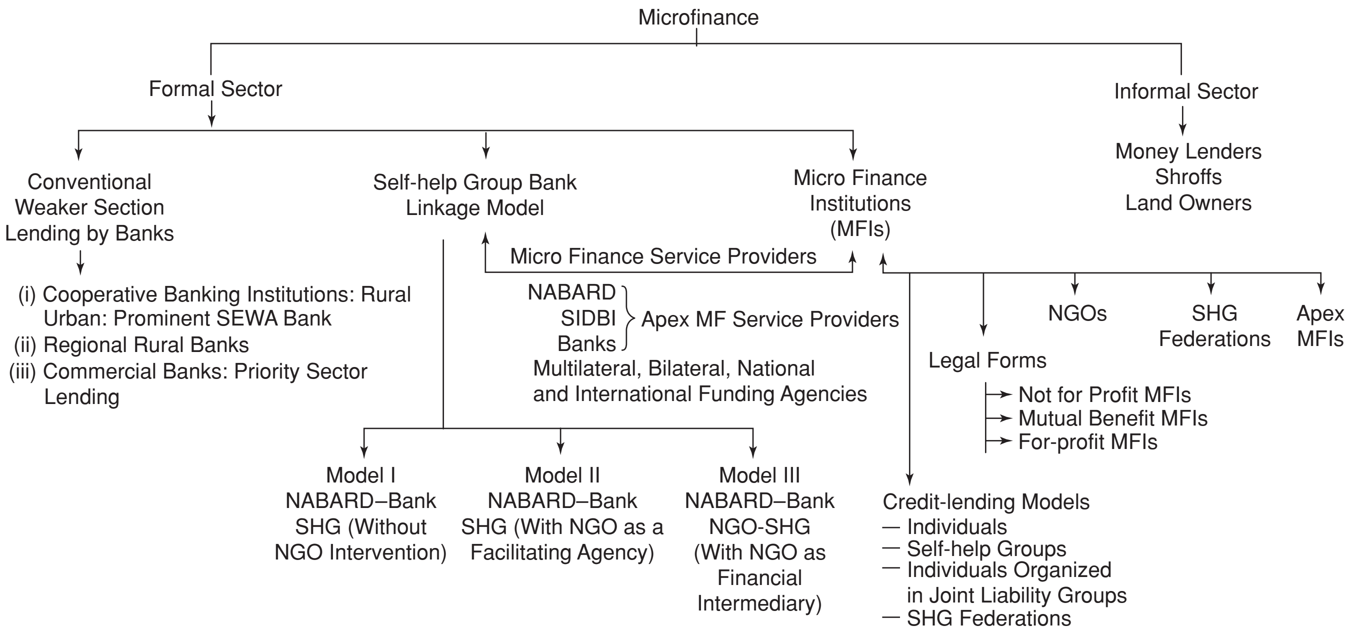

Figure 23.1 Microfinance

An SHG is a registered or unregistered group of 15–20 members, who have a relatively homogeneous, social and economic background, and have voluntarily come together to save small amounts regularly to a common fund and to meet their emergency needs on mutual-help basis. This common fund may not be sufficient enough to lend to its members and hence, it seeks an external funding from banks to support the income-generating activities. Very often, there is a self-help promoting which enables them to organize and function smoothly. The formation of SHGs reduces the transaction cost for both the lenders as well as the borrowers. Moreover, groups have reliable information about their members and group guarantees can replace collateral, which poor cannot give. It is cheaper to deal with a group than with individuals. A large number of SHGs have women as their members. Women have a tendency to save and are more concerned about the future of their children and family, get adjusted easily in a group, borrow small amounts, and repay regularly and sincerely. Microfinance is used by SHGs to meet the survival needs, diversify their basket of income-generating activities, meet working-capital requirements in traditional activities and set up micro-enterprises. The SHGs are widely viewed as being better managers of money, more transparent and accountable than most other community groups.

SHG–Operational Methodology

- Village meeting of women in villages by MFI.
- Group Formation.
- Group Training for 5–7 days on procedures and business development skills.
- Group Meeting once in a week for mobilizing savings, disbursing and repaying loans.
- MFI facilitates capacity building, group dynamics and monitors credit discipline through field staff.

Microfinance Delivery Mechanisms

In India, in the course of evolution of microfinance, several approaches for providing microfinance services to the poor have emerged. These are:

1. Conventional weaker-section lending by banks.
2. MFIs.
3. SHG–bank linkage programme.

Figure 23.1 Provides an overview of microfinance in India.

(1) Conventional Weaker-section Lending by Banks

Banks are providers of microfinance. The cooperative banks and the regional rural banks were set up specifically to cater to the needs of both rural as well as urban poor. The commercial banks—both the private sector and the public sector—lend loans for agricultural as well as other allied activities, as part of the priority-sector lending, mandated by the RBI. The success of many MFIs and the SHG–bank linkage programme has motivated many private-sector banks and foreign banks to actively participate in microfinance. They are lending funds to MFIs and some have raised funds from the capital market to finance the microfinance activity. ICICI Bank, the second-largest commercial bank in India, is a prominent player among the commercial banks in microfinance sector. It has doubled its rural microfinance and agriculture business loans. The bank increased its partner strength and is partnering with around 400 MFIs. The bank is planning to develop a rural banking proposition by capitalizing on the partnership model. The first micro-loan securitization in the world was between Samruddhi, an MFI, and ICICI Bank on November 20, 2003. ICICI Bank bought Samruddhi's crop loans, worth ₹42.1 million.

(2) Microfinance Institutions (MFIs)

They are institutions whose major business is the provision of financial services. The Task Force on Supportive Policy and Regulatory Framework for Microfinance (NABARD), 1999, defines MFIs 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.' A variety of MFIs catering to the needs of poor exist in India. There are around 900 MFIs with varied legal forms. The MFIs can be classified into the following three categories, based on their legal structure:

(a) Not-for-profit MFIs

1. Societies registered under Societies Registration Act, 1860 or similar State Acts.
2. Public Trusts registered under the Indian Trust Act, 1882.
3. Non-profit companies registered under Section 25 of the Companies Act.

Sources of Funding of MFIs

- Donors
- Banks
- SIDBI
- Private Equity
- Venture Capital Funds
- Capital Market

MFIs such as ASSIST and Lupin are registered as societies. An MFI which is registered as a society/trust finds difficulty in raising funds when they have achieved a loan-outstanding level of ₹25 lakhs and above, from the point of the view of Income Tax Act. Society/Trust does not have the concept of equity. MYRADA has established Sanghamithra Rural Financial Services as a Section-25 company.

(b) Mutual-benefit MFIs

1. State Credit Cooperatives.
2. National Credit Cooperatives.
3. Mutually Aided Cooperative Societies (MACs) set up under MACS Act, enacted by the Government of Andhra Pradesh in 1955. This law grants functional autonomy to cooperatives that are not receiving funds from the government.

(c) For-profit MFIs Non-banking financial companies (NBFCs) are registered under the Companies Act, 1956, and regulated by the RBI. More than two-thirds of the MFIs are in the form of NBFCs.

NBFCs, such as Sanghamitra, Bangalore; SHARE Microfin Ltd, Hyderabad; Indian Association for Savings and Credit (IASC), Marthandam, Tamil Nadu; and Cashpor Financial and Technical Services (CFTS), Mirzapur, Uttar Pradesh; have exclusive poor clients. An increasing number of MFIs are seeking NBFC status from the RBI to get a wider access to funding including bank finance.

(d) Cooperative MFIs Manndeshi Mahila Bank in Maharashtra, sponsored by HSBC, was the first to receive a cooperative license from the RBI.

Majority of the MFIs have around 500–1,500 clients. The top-three MFIs in India are SHARE Microfin, SKS and Spandana, with a clientele of over 5,00,000.

Other MFIs

(i) SHG federations: An SHG federation is a democratic body formed by SHGs, belonging to a certain geographical area, to represent their common cause to policy-making bodies and facilitate a linkage between SHGs and other agencies. SHG federations are registered mostly as charitable societies. Development of Human Action (DHAN) Foundation further refined the concept of SHGs and helped them to set up federations. SHG federations are formed at two levels—cluster/village-level federations and block/district-level federations. These federations help build solidarity among members. Manavi, an MFI, has 125 SHGss with over 1,500 members. It has formed seven federations out of this group to interact with banks and other agencies.

(ii) Apex MFIs: Rashtriya Mahila Kosh (RMK), the Friends of Women's World Banking (FWWB), Ahmedabad; and Rashtriya Gramin Vikas Nidhi, Guwahati; are the apex MFIs. These institutions provide indirect-support services to MFIs. They are also referred to as wholesale MFIs. They help their members to build capacity, design and implement new products, grant capital, offer a loan guarantee to encourage banks to wholesale funds, and undertake policy initiatives.

(iii) Association of MFIs: Sa-Dhan is the designated national association of Community Development Finance Institutions. It plays a crucial role in increasing capacities, affecting the evolution and development of best practices, increasing the number of service providers, and contributing to improving the policy and operational context for microfinance in India.

The National Bank for Agriculture and Rural Development (NABARD) and the Small Industries Development Bank of India are the apex-microfinance service providers. NABARD is the promoter and regulator of the SHG–bank linkage programme. The Small Industries Development Bank of India (SIDBI) launched the SIDBI Foundation in January 1999, to provide financial and non-financial services to MFIs, so as to facilitate their development into financially viable activities. Multilateral-lending agencies and bilateral-development agencies support the development of microfinance.

Credit-lending methodologies differ from one MFI to another. The major credit-lending models of various MFIs are:

1. Direct lending to individuals organized in joint-liability groups.
2. Lending to SHGs.
3. Lending to SHG federations.

The MFIs have done a commendable job of increasing the outreach of microfinance. Their growth is constrained as they are deprived of equity capital and have no access to public deposits. They rely on loans from banks to fund their growth. They need capital for growth and building capacity.

- This programme was launched by NABARD envisaging synthesis of formal financial system and informal sector.
- Commercial banks have the maximum share of SHG's savings and credit.

(3) SHG–Bank Linkage Programme

This programme was launched by NABARD in February 1992 with the support of the RBI. The programme initially aimed at promoting and financing 500 SHGs across the country. Under this programme, small groups of the poor were encouraged to pool their savings regularly; and from this pool, small interest-bearing loans were made to members. Subsequently, bank credit was made available to the group to augment its resources for lending to its members. The pilot phase was followed by setting up a working group on NGOs and SHGs, by the RBI in 1994, which came out with wide-ranging recommendations on internalization of the SHG concept, as a potential intervention tool in the area of banking with the poor. The RBI accepted most of the major recommendations and advised the banks to consider lending to the SHGs, as part of their mainstream rural-credit operations.

The SHG–bank linkage programme is a partnership model between three agencies, namely, the SHGs, banks and the NGOs. NABARD operates three models under this programme. They are:

Model I: NABARAD–Bank–SHG. Under this model, SHGs are formed and financed by banks. There is no NGO intervention. NABARD supports banks and banks, in turn, support SHGs. Around 14 per cent of the SHGs were financed by banks under this model.

Model II: NABARD–Bank–SHG (with NGO as a facilitating agency). Under this model, the NGOs will promote SHGs and link them with banks. SHGs formed by NGOs are directly financed by banks. This is the most popular model. About 80.7 per cent of the SHGs were financed by banks under Model II.

Model III: NABARD–Bank–NGO–SHG (with NGO as the financial intermediary). Funds flow from NABARD to banks and from banks to NGOs. The SHGs are financed by banks through NGOs. About 5 per cent of the SHGs were financed by banks under this model.

NABARD in 1998 formulated its mission for providing access to one-third of the rural poor by linking of one million SHGs by 2007. This mission was achieved well ahead of the schedule. More than 79 lakhs, SHGs were financed by banks till March 31, 2016, covering over 10 crore poor families with savings bulance of over ₹7000 crore. Commercial banks had the maximum share in savings of SHGs and disbursement of loans to SHGs.

A notable feature of this programme is that 95 per cent of the loans are timely repaid. To consolidate and expand this programme, NABARD provided active support to partner agencies such as NGOs, RRBs, cooperatives, farmers' clubs and individual volunteers for their capacity building. It also initiated efforts to scale up the programme in the states where the incidence of poverty was high. NABARD launched a micro-enterprise development programme (MEDP) during 2005–06. It also launched a scheme called Capital/Equity Support to MFIs, to enable them to leverage capital/equity for accessing commercial and other funds from banks for providing financial services at an affordable cost to the poor and achieve sustainability in their operations.

SHG-Bank Linkage Programme

- It is the largest microfinance programme in terms of outreach in the world.
- It is recognized as a part of priority sector lending by the RBI.
- 85% of the groups linked with the banks were formed exclusively by women.

To supplement the efforts of banks in this programme, NABARD has collaborated with institutions such as post offices for financing SHGs, promoted by NGOs. Post offices open savings accounts in the name of SHGs, promoted by identified NGOs and give term loans to these SHGs, repayable within 2 years in 24 monthly instalments. Post offices charge an interest of 9 per cent per annum, on the loans given to SHGs, using a reducing balance method, but do not collect any loan. Post offices are allowed to retain an interest margin of 3 per cent and the amount of actual interest collected from the SHGs is shared between NABARD and the post offices in the ratio of 2 : 1. NABARD, in turn, provides financial support for capacity-building programmes of postal officials. This collaboration paves the way for expansion of microfinance programme in areas where the branch network is poor.

Opening of Savings Bank A/c: The SHGs registered or unregistered which are engaged in promoting savings habits among their members would be eligible to open savings bank accounts with banks. These SHGs need not necessarily have already availed of credit facilities from banks before opening savings bank accounts. KYC verification of all the members of SHG need not be done while opening the savings bank account of the SHG as KYC verification of all the office bearers would suffice. Further, it is clarified that since KYC would have already been verified while opening the savings bank account and the account continues to be in operation and is being used for credit linkage, no separate KYC verification of the members or office bearers is necessary at the time of credit linking of SHGs.

SHG 2 – Revisiting SHG Bank LInkage Programme

The SHG Bank linkageguidelines issued two decades back by NABARD were revisited and revised guidelines were issued after holding numerous rounds of discussions with various stakeholders. The key changes in the guidelines include allowing voluntary savings; for SHG members either by opening individual bank accounts/reviving existing "no frill accounts" or by depositing the voluntary savings within the SHG corpus without any additional entitlements. The approach is intended to facilitate SHG members to steadily graduate from community banking to individual banking. The second key feature of SHG 2 is about extending initial loans to SHG as flexible cash credit facility instead of term loans. The guidelines also suggest creation of enterprise/livelihood based groups (jl.Gs) within the SHGs as a separate entity without disturbing the functioning of SHGs' which can cater to higher loan requirements of a few enterprising members, It further envisages risk mitigation mechanisms like audits, ratings and also leveraging active members of SHGs to serve as Business Facilitators for helping the bank monitor the functioning of SHGs,

RESOURCES FOR SUPPORTING MICROFINANCE

Microfinance Development Fund (MFDF)

Looking to the success of the SHG–bank linkage programme, the RBI and NABARD designed an integrated programme which would help in the holistic development of the entrepreneur by providing him services such as marketing infrastructure, technology and design development.

In April 2000, NABARD set up a separate fund, the Micro Finance Development Fund, for promotion and development of the microfinance sector with an initial contribution of ₹100 crores—₹40 crores each from the RBI and NABARD and ₹20 crores from 11 public-sector commercial banks. NABARD has further contributed ₹6 crores from its operational surplus during the last 4 years to the corpus. The fund became fully operational on March 7, 2003.

This fund supports broadly the following activities:

- Giving training and exposure to SHG members, partner NGOs, banks and government agencies.
- Providing start-up funds to MFIs and meeting their initial operational deficits.
- Meeting the cost of formation and nurturing of SHGs.
- Designing new delivery mechanisms.
- Promoting research, action research, management-information systems (MISs) and dissemination of best practices in microfinance.

This fund helps in furthering the cause of banking with the poor. The fund is being utilized for scaling up various microfinance initiatives, with a special focus on capacity building, under the SHG–bank linkage programme. The scaling-up efforts emphasise on evolving region-specific strategies for promoting quality SHGs through a synergy of objectives among stakeholders, encouraging proper rating of SHGs by banks and building a proper MIS.The fund is also used for providing loan in the form of revolving financial assistance (RFA) to MFIs. The Microfinance Development Fund was re-designated as Micro Finance Development and Equity Fund in 2005.

Collaboration with External Agencies

NABARD has collaborated with external agencies like the Swiss Agency for Development Cooperation (SDC) for improving the efficiency of credit delivery to rural borrowers and GTZ, Germany, for capacity building. The Credit and Financial Services Fund (CFSF) was set up through the assistance of the SDC. Under the project for NABARD–GTZ technical collaboration—linking of SHGs to banks, GTZ provided technical support for up-scaling the SHG–bank linkage programme. The main objective of this project was capacity building at different levels and promoting greater participation of the people. NABARD has received ₹52 crores from GTZ Germany till March 31, 2004.

The SHG–bank linkage programme is the largest microfinance programme of the world in terms of its outreach. As on March 31, 2006, this programme enabled an estimated 329.80-lakh poor households in the country, to gain an access to microfinance activities from the formal banking system.

A study commissioned by NABARD in 2000, which covered 560 SHG member households from 223 SHGs, spread over 11 states, found that:

- Average value of assets increased by 72 per cent from ₹6,843 to ₹11,793.
- Average annual savings per household registered over three-fold increase from ₹460 to ₹1,444.
- Average borrowings per year per household increased from ₹4,282 to ₹8,341. Nearly, 70 per cent of loans was used for income-generating activities.
- Average net income increased per household by about 33 per cent.

Small Industries Development Bank of India (SIDBI) launched its microfinance programme in February 1994 and is one of the largest providers of microfinance through the MFIs. It pioneered the concepts of capacity-assessment rating (CAR) in 1999 and 'transformation loan' in 2003 for the MFIs. The transformation loan is a quasi-equity product with longer repayment period and features for conversion into equity at a later date. It enables the MFI to convert itself into a corporate entity.

The Micro Financial Sector (Development and Regulations) Bill, 2007

It was introduced in the Lok Sabha on March 20, 2007. The Bill seeks to provide for promotion, development and orderly growth of the microfinance sector in rural and urban areas to ensure that small borrowers gain access to integrated financial services. The Bill defines 'microfinance services' as a means for:

Box 23.1 Micro Finance Institutions (Development and Regulation) Bill, 2012 and its Impact on the Microfinance Sector

The Micro Finance Institutions (Development and Regulation) Bill, 2012 aims at providing a framework for the development and regulation of micro-finance institutions. The Bill defines a micro-finance institution (MFI) as an organization, other than a bank, providing micro-finance services as micro credit facilities not exceeding ₹5 lakh in aggregate, or with the Reserve Bank's specification of ₹10 lakh per individual. Subsidiary services like collection of thrift, pension or insurance services and remittance of funds to individuals within India also come under these services. The Bill allows the Central Government to create a Micro-Finance Development Council (MFDC) that will advise on policies and measures for the development of MFIs. Besides, the Bill allows the Central Government to form State Micro-Finance Councils (SMFC), which will be responsible for co-ordinating the activities of District Micro-Finance Committees in the respective states.

District Micro-Finance Committees (DMFC) can be appointed by the Reserve Bank. The Bill requires all MFIs to obtain a certificate of registration from the Reserve Bank. The applicant needs to have a net owned fund (the aggregate of paid-up equity capital and free reserves on the balance sheet) of at least ₹5 lakh. The Reserve Bank should also be satisfied with the general character or management of the institution.

Every MFI will have to create a reserve fund and the Reserve Bank may specify a percentage of net profit to be added annually to this fund. There can be no appropriation from this fund unless specified by the Reserve Bank. At the end of every financial year, MFIs are required to provide an annual balance sheet and profit and loss account for audit to the Reserve Bank. They will also have to provide a return, detailing their activities within 90 days of the Bill being passed. Any change in the corporate structure of a MFI, such as shut-down, amalgamation, takeover or restructuring can only take place with approval from the Reserve Bank.

The Bill has entrusted the Reserve Bank with the power to issue directions to all MFIs. This could include directions on the extent of assets deployed in providing micro-finance services, ceilings on loans or raising capital. The RBI has the authority to set the ceiling on the rate of interest charged and the margin by MFIs. Margin is defined as the difference between the lending rate and the cost of funds (in percentage per annum).

The Reserve Bank shall create the Micro-Finance Development Fund (MFDF). The sums are raised from donors, institutions and the public along with the outstanding balance from the existing Micro-Finance Development and Equity Fund. The central government, after due appropriation from Parliament, may grant money to this fund. The fund can provide loans, grants and other micro-credit facilities to any MFIs.

The Reserve Bank is responsible for redressal of grievances for beneficiaries of micro-finance services. The Reserve Bank is empowered to impose a monetary penalty of up to ₹5 lakh for any contravention of the Bill's provisions. No civil court will have jurisdiction against any MFI over any penalty imposed by the Reserve Bank. The Bill gives the Central Government the authority to delegate certain powers to the National Bank for Agriculture and Rural Development (NABARD) or any other Central Government agency. However, the Central Government has the power to exempt certain MFIs from the provisions of the Bill.

The Bill and its likely Impact on the Microfinance Sector

The Bill envisages that the Reserve Bank would be the overall regulator of the MFI sector, regardless of legal structure. The Reserve Bank has provided the views on the Bill to the Government of India. The aims of the Bill are to regulate the sector in the customers' interest and to avoid a multitude of microfinance legislation in different states. The proper balancing of the resources at the Reserve Bank to supervise these additional sets of institutions besides the existing regulated institutions could be an important issue. Requiring all MFIs to register is a critical and necessary step towards effective regulation. The proposal for appointment of an Ombudsman will boost the banking industry's own efforts to handle grievances better. Compulsory registration of the MFIs would bring the erstwhile money-lenders into the fold of organized financial services in the hinterland who had been acting as MFIs hitherto.

Source: RBI, Report on Trend and Progress of Banking in India, 2011–12.

1. providing financial assistance to an individual or an eligible client being under any of the sub-clauses (i) to (vi) of Clause (b), either directly or through a group mechanism for (A), an amount, not exceeding ₹50,000 in aggregate per individual, for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual); or (B) an amount not exceeding ₹1,50,000 in aggregate per individual, for housing purposes; or (C) such other amounts, for any of the purposes mentioned at items (A) and (B) above or other purposes, as may be prescribed;
2. financial services to an eligible client or individual borrower under any of the sub-clauses (i) to (vi) of Clause (b), through the BF or BC mechanism, authorized by the scheduled banks or any such other agency, as may be permitted by the RBI;
3. life-insurance- or general-insurance services and pension services which have been approved by the authority, regulating such services;
4. any other services, as may be specified by regulations made by the National Bank.

The Bill proposes to empower NABARD to function as the developer and regulator of the microfinance sector and formulate policies for its orderly growth, so as to ensure transparency, effective management and good governance. It would be mandatory for MFIs to register with NABARD. For safeguarding the interests of depositors, a reserve fund would be set up in which a minimum 15 per cent of the net profit or surplus realized out of thrift services is to be parked. The Bill also proposes to set up a corpus called the Micro Finance Development and Equity Fund, for the development of the microfinance sector and microfinance ombudsman, for settlement of disputes. The Bill has been referred to the Standing Committee Finance.

Micro Finance Industry

The success of the SHG–bank linkage programme has proved that poor are creditworthy and bankable. Financial services can be provided to the poor at commercial rates. Microfinance is a powerful vehicle in the upward and socio-economic transition of the poor. It has reduced household vulnerability to risks, provided higher income and greater security, and reduced social exclusion. It also helps the poor to cope with the natural disasters by helping them to diversify their income services and build portable assets which can be protected from these disasters. It empowers women by enabling them to become the economic agents of charge. Also, the individual lending of microfinance is gaining speed and in the process, changing many lives.

Corporates have successfully penetrated the rural markets through SHGs. Hindustan Lever Limited, under its project Shakti, offers a wide range of its products to the SHGs, comprising of women. This model has created a win–win partnership between HLL and SHGs. This project has not only enabled the company to successfully tap the rural markets, but has also created income-generating capabilities for rural women and transformed many into successful entrepreneurs.

The key players in the micro finance industry are banks, MFIs-NBFCs, NGOs, NABARD, SIDBI, MUDRA Bank, Bandhan Bank and IDFC Bank. Now the micro finance industry (NBFC-MFI which constitutes 90 per cent of the industry) is regulated by the Reserve Bank of India with MFIN as the SRO for the industry. Now the term micro finance has become broader to include products such as microcredit, micro insurance and micro pension. Attempts have been made by the players to increase their presence in under banked and underserved places with emphasis on creating financial literacy and awareness integrated to product delivery.

MICRO FINANCE INDUSTRY MILESTONES

- 2010 – The first IPO in the industry (and still the only).
- 2011 – Creation of the NBFC-MFI category by the Reserve Bank of India.
- 2012 – Introduction of the Microfinance Bill in Parliament.
- 2013 – Malegam Committee's recommendations fully implemented and industry firmly back on the growth path.
- 2014 – MFIN recognized as SRO by the RBI—a first ever in the financial services industry.
- 2015 – Small finance bank framework (and the MUDRA bank announcement)
  – Bandhan Micro Finance, one of the largest MFI, transformed into a universal bank in August, 2015.
  – Micro Units Development and Refinance Agency Ltd. (MUDRA) launched on April 8, 2015.
- 2016 – Eight MFIs given in-principle approval by RBI as small finance banks.

NBFC-MFI: Microfinance refers to loans up to ₹1 lakh, usually extended to individuals who lack access to financial services—especially credit. Microfinance in India started in the late 1980s in response to the gap in availability of formal sources of credit and lending to the underserved and low-income population. The majority of the institutions that forayed into the sector were from the social sector and hence the legal entities comprised of 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. To serve the credit side financial needs of these micro entrepreneurs, Micro Finance Institutions (MFI) model has proved scalable and viable—employing over 1 lakh youth. Despite the intensive banking coverage, MFIs have become the preferred source for more than 32 million customers primarily due to the ease of access and doorstep delivery of credit. MFIs have been able to show that it is possible to achieve scale in sustainable business even when dealing with vulnerable populations.

NBFC-MFIs have been playing a significant role in taking forward the financial inclusion agenda of the Government of India. In the decade leading up to 2009, the NBFC-MFI model proved itself to be a viable and sustainable means of providing access to finance to meet the requirements of low-income households. NBFC-MFIs, which constitute more than 90 per cent of the micro finance sector, are regulated by the RBI with MFIN acting as the SRO (self-regulatory organization). Other MFIs registered under various state society acts are not regulated by any regulating agency.

What sets 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 no access to the banking system. The industry has used market oriented solutions that encourage self-reliance and entrepreneurship amongst its clients. As on 31st March 2016, NBFC-MFIs provided credit to over 3.25 crore clients, with a total lending in excess of ₹53,000 crores.

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

RBI Regulations for NBFC-MFIs:

NBFC-MFIs are required to have not less than 85 per cent of the net assets in the nature of qualifying assets, satisfying the following criterion:

- Minimum NOF (Net Owned Fund) of ₹5 cr. (North-East Region, ₹2 cr.)
- 85 per cent of total assets of MFI are in nature of qualifying assets.

Qualifying asset means a loan which satisfies the following criteria:

- The loan extended to a borrower whose household annual income in rural areas does not exceed ₹100,000 while for non-rural areas it does not exceed ₹160,000.
- Loan does not exceed ₹60,000 in the first cycle and ₹100,000 in the subsequent cycles.
- Total indebtedness of the borrower does not exceed ₹100,000.

Education and medical expenses are excluded while arriving at the total indebtedness. Tenure of the loan is not less than 24 months when loan amount exceeds ₹15,000 with the right of the borrower prepay without penalty. Loans to be extended without collateral. Aggregate amount of loans given for income generation should constitute at least 50 per cent of the total loans of MFIs so that the remaining 50 per cent can be for other purposes such as housing repairs, education, medical and other emergencies.

Loan is repayable by weekly, fortnightly or monthly instalments at the choice of the borrower.

The average interest rate on loans during a financial year does not exceed the average borrowing cost during that financial year plus the margin, within the prescribed cap limits. The rate of interest on individual loans may exceed 26 per cent; the maximum variance permitted for individual loans between the minimum and maximum interest cannot exceed four per cent.

Margin cap limits at 12 per cent for small MFIs and 10 per cent for large MFIs (whose loan portfolios exceed ₹100 crore).

Only three components are to be included in pricing of loans, viz., a) processing fees not exceeding one per cent of the gross loan amount, b) the interest charged, and c) the insurance premium.

There should not be any penalty for delayed payment. No security deposit/margin is to be taken. Capital requirement (CRAR): 15 per cent of its aggregate risk weighted assets.

Provisioning: 50 per cent of the aggregate loan instalments which are overdue for more than 90 days and less than 180 days and 100 per cent of the aggregate loan instalments which are overdue for 180 days or more. Follow RBI's Fair Practices Code. The MFIs must be members of all Credit Information Bureau (CIBs) and onboard data to all Credit Bureaus as mandated by the RBI.

Micro Finance Institutions Network (MFIN) was established in October, 2009 under the Andhra Pradesh Societies Registration Act, 2001. As per its bye-laws all financial institutions that are 'substantially engaged in the business of microfinance' and are registered as NBFCMFIs with the Reserve Bank of India, are eligible for membership to MFIN. It is structured as a Self-Regulatory Organization (SRO) of the RBI regulated NBFC-MFIs. A Self-Regulatory Organization (SRO) is an organization that exercises some degree of regulatory authority over an industry. The four key aspects of self-regulation are designing the rules, adopting them, monitoring compliance and achieving the objective following the rules put in place. In India, there are three kinds of SROs—independent statutory organizations set up by an act of Parliament such as the Institute of Chartered Accountants or the Medical Council of India; recognized voluntary organizations, such as the Indian Banks' Association and the Association of Mutual Funds in India; and voluntary organizations, such as the Advertising Standards Council of India and the Institute of Engineers. Till RBI's recognition in June 2014, MFIN was a voluntary SRO. MFIN is India's first licensed Self Regulatory Organization (SRO) in the financial services sector.

MFIN has been supporting an effective framework for responsible lending and client protection for the industry. MFIN works closely with regulators and other key stakeholders and plays an active part in the larger financial inclusion dialogue through the medium of microfinance. It has positioned itself as an engine of inclusive growth in India. MFIN, through its members help, provides financial services to low-income households in a responsible and transparent manner, thereby helping them build sustainable livelihoods. MFIN's primary objective is to work towards the robust development of the microfinance sector by promoting responsible lending, client protection, good governance and a supportive regulatory environment.

Out of total 67 NBFC-MFIs registered with the RBI, 53 are members of MFIN. Market share within the industry is concentrated with groups of 22 large MFIs, which account for almost 90 per cent of the industry assets, client base, loan amount disbursed and funding.

As on 31st March, 2016, MFIN members hold a portfolio in excess of ₹53,000 crores covering around 3.25 crores clients across 26 states serviced through more than 9500 branches manned by over 85,000 employees.

MUDRA was announced by the Union Finance Minister, Arun Jaitley, while presenting Union Budget for FY 2015–16. MUDRA was formed on March 18, 2015, as a wholly owned subsidiary of the Small Industries Development Bank of India (SIDBI), and is registered as a non-deposit taking non-banking financial institution (NBFI) with the Reserve Bank of India (RBI). Launched by Hon'ble Prime Minister, Narendra Modi on April 8, 2015, MUDRA has been set up as a refinancing agency for last-mile financial institutions, such as banks, microfinance institutions (MFIs) and non-banking financial companies (NBFCs) that extend credit to micro enterprises, engaged in manufacturing, trading or services, whose credit requirements do not exceed ₹10 lakh.

MUDRA, aims at creating income and employment opportunities for a large number of micro entrepreneurs. As per the National Sample Survey Office (NSSO) 2013 Survey, there are around 5.77 crore micro units, engaging around 10 crore people. These micro units depend on high-cost funds accessed outside the formal credit system. Hence, MUDRA was formed to bridge this gap and facilitate 'funding the unfunded'. With this mission, MUDRA commenced operations in April, 2016. As announced by the finance minister in the Budget, RBI set up a MUDRA refinance corpus of ₹20,000 crore, earmarked from the priority sector lending shortfall of the banks. MUDRA has availed of ₹5000 crore out of the available corpus.

MUDRA is expected to serve millions of small borrowers through better governed MFIs offering suitable products at affordable costs, and thereby ensure growth and strengthening of the microfinance sector in India.

Pradhan Mantri Mudra Yojana The Pradhan Mantri Mudra Yojana (PMMY) envisages providing MUDRA loans up to ₹10 lakh, by public/private sector banks, RRBs and MFIs to income-generating micro enterprises engaged in manufacturing, and in the trading and services sectors. The overdraft amount of ₹5000 sanctioned under Pradhan Mantri Jan Dhan Yojana (PMJDY) has also been classified as a MUDRA loan under PMMY. MUDRA has created three products/schemes—Shishu (or infant), Kishore (or youth), Tarun (or young adult). These names signify the stage of growth/development and funding needs of the micro unit/entrepreneur, funded under the scheme.

The future of the micro finance industry depends on strengthening the credit culture, a common code of conduct for all lenders to clients in the sector, use of risk management/financial controls/IT infrastructure in the sector, enhanced ground level support, surveillance and topical research. It is important that the RBI's regulations for MFIs and priority sectors work hand-in-glove with the MUDRA initiative. There are challenges of pricing of loans in order for the business to become viable and also to ensure it is politically acceptable. The MUDRA card will provide working capital for micro entrepreneurs and will require high level of coordination between banks, MFIs and MUDRA. The microfinance sector is not free from risks. There are many operational, attitudinal and policy-level constraints. There is lack of transparency and absence of governance structure. The growth of microfinance is skewed with a large proportion of SHGs formed in the southern states of India. Regulation can create a discipline and foster the development of sound MFIs. The success will depend on coordination and execution between key players in the industry.

KEY TERMS

Business Facilitator and Business Correspondent

Financial Inclusion

Microfinance

Microfinance Institutions

SUMMARY

1. Even after more than 35 years of nationalization, more than 40 per cent of the adult population in India has no access to formal banking and financial services.
2. Financial exclusion leads to loss of opportunities of growth for an individual, which, in turn, leads to loss of output for an economy and a reduction in societal welfare.
3. Financial inclusion is to be undertaken in three steps:
   a. Providing access to financial products and services.
   b. Availability of financial products and services in a fair and equitable manner.
   c. Credit counselling which includes providing sound services to arrest deterioration of incomes, restructuring of debt solution to overcome debt burden and improve money-management skills.
4. In November 2005, banks were advised to make available a basic banking, no-frills account, with low or nil minimum balances through simplified KYC procedures as well as charges to expand the outreach of such accounts to vast sections of the population.
5. In January 2006, the RBI, permitted banks to utilise the services of NGOs/SHGs, MFIs (other than NBFCs) and other civil-society organisations, as intermediaries, for providing financial and banking services, through the use of BF and BC models.
6. An alternative delivery mechanism, for meeting the requirements of the poor, known as ‘microfinance’ came into existence. Microfinance in India evolved to fill the gaps created by the formal banking institutions.
7. Several approaches for providing microfinance services to the poor have emerged. These are:
   a. Conventional weaker-section lending by banks.
   b. MFIs.
   c. SHG–bank linkage programme.
8. The SHG–bank linkage programme is a partnership model between three agencies, namely, the SHGs, banks and NGOs. NABARD operates three models under this programme.
9. In April 2000, NABARD set up a separate fund, the Micro Finance Development Fund, for promotion and development of the microfinance sector with an initial contribution of ₹100 crore.
10. The potential for the microfinance industry is still large.

REVIEW QUESTIONS

1. What is financial exclusion? State the reasons for financial exclusion.
2. Define financial inclusion. What initiatives have been undertaken to enlarge financial inclusion?
3. What is a no-frills account? Why is it being offered by banks?
4. Explain the BF and BC models.
5. Describe the SHG–bank linkage programme.
6. Compare the SHG–bank linkage programme and the Grameen Bank model of Bangladesh.
7. ‘The potential for the microfinance industry is still large.’ Discuss.

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