STATUS, BENEFITS, CHALLENGES AND SOLUTIONS OF MICROFINANCE –A STUDY

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ABSTRACT;- Micro Finance is defined as 'provision of 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**'. It is an economic tool designed to **promote financial inclusion** which enables the poor and low-income households to come out of poverty. This empowerment takes various forms, from fostering entrepreneurship and livelihood generation to promoting women's economic autonomy and enabling access to critical services like education and healthcare. Moreover, microfinance often operates through community-based models like Self-Help Groups (SHGs), fostering social cohesion and community development. As a result, microfinance acts as a catalyst for financial inclusion, poverty alleviation, gender equality, and overall local economic growth, driving sustainable development in diverse contexts worldwide. **Micro credit**: Micro credit is the extension of **very small loans** to borrowers who typically lack collateral, steady employment or income stream and verifiable credit history. It is designed to support small-scale entrepreneurship, alleviate poverty, empower women and uplift the poor social class by extension. Microcredit is delivered through a variety of institutional channels including Scheduled Commercial Banks (through Business Correspondents), Regional Rural Banks (RRBs), Cooperative Banks, Non-Banking Financial Companies (NBFCs) and Microfinance Institutions (MFIs). **Government Programmes**: **SHG-Bank Linkage Programme** (SHG-BLP): This channel was initiated by NABARD in 1992. This model incentivises women to unite together to form a group of 10-15 members. Women belonging to financial backward classes contribute by giving their individual savings to the group at regular intervals. Loans are provided to the members of the group by their contributions;

KEY WORDS- **MICROFINANCE, NABARD, RBI, COMMERCIAL BANKS, LOANS, FINANCIAL INCLUSION**, **COLLATERAL-FREE LOANS**

Introduction

The RBI had recently released its 26th Financial Stability Report (December 2022). In the report, the RBI remarked that the credit to the Microfinance sector has grown at a steady pace. However, the report highlighted the building stress levels in the loans portfolio (i.e., bad loans are increasing).

The share of loans overdue by more than 90 days has risen to 14% in September 2022, from 12% in March 2022. Microfinance is considered a potent tool to ensure balanced and inclusive growth, especially by providing access to credit to the rural citizens and small entrepreneurs. The rising delinquency (Being delinquent refers to a situation wherein the borrower is overdue on a loan payment by a certain number of days) in Microfinance is indicative of the challenges faced by the sector.

The Government has been supporting the sector through various initiatives. The Government has to step in to address the issues faced by the sector.

The meaning of Microfinance

Micro Finance is defined as 'provision of 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**'. It is an economic tool designed to **promote financial inclusion** which enables the poor and low-income households to come out of poverty.

Microfinance refers to a variety of financial services that target low income people, particularly women. Since the clients of microfinance institutions (MIF's) have lower incomes and often limited access to other financial services, microfinance products trend to be for smaller monetary amounts than traditional financial services.

Microfinance Defines: A good definition of Microfinance given by Robinson is "Microfinance defines as a small –scale financial services for both credits and deposits that provided to people who farm or fish or herd; operate small or microenterprises where goods are produced and recycled, repaired, or traded.

The importance of microfinance

Microfinance holds profound importance as a potent tool for socio-economic transformation, particularly in low-income and underserved communities. By providing financial services such as credit, savings, insurance, and payment systems to individuals who are traditionally excluded from formal financial institutions, microfinance empowers individuals to break free from the cycle of poverty.

This empowerment takes various forms, from fostering entrepreneurship and livelihood generation to promoting women's economic autonomy and enabling access to critical services like education and healthcare. Moreover, microfinance often operates through community-based models like Self-Help Groups (SHGs), fostering social cohesion and community development. As a result, microfinance acts as a catalyst for financial inclusion, poverty alleviation, gender equality, and overall local economic growth, driving sustainable development in diverse contexts worldwide.

The importance of microfinance extends beyond financial empowerment, as it addresses broader issues of social inequality and economic disparity. It recognizes the potential of marginalized communities and leverages financial tools to unlock that potential, facilitating grassroots development and creating pathways for individuals to actively contribute to their own betterment. By offering opportunities for self-sufficiency, resilience-building, and fostering a sense of ownership and agency, microfinance serves as a critical bridge towards a more equitable and inclusive society.

The current status of microfinance in India

Microfinance recorded a growth of 21% in FY2023 at INR 3,51,521 crore, compared to the previous year's INR 2,89,845 crore, as per a report by Sa-Dhan. The same report states that NBFCs and MFIs have recorded double-digit growth in the same period (49% and 37%, respectively). Total disbursements of all lenders was at INR 3, 19,948 crore compared to INR 2,53,966 crore in FY 2021-22. Additionally, the number of loan accounts for microfinance recorded a YoY growth of 10% in FY 2022-23.

Components of Microfinance

Micro credit: Micro credit is the extension of **very small loans** to borrowers who typically lack collateral, steady employment or income stream and verifiable credit history. It is designed to support small-scale entrepreneurship, alleviate poverty, empower women and uplift the poor social class by extension. Microcredit is delivered through a variety of institutional channels including Scheduled Commercial Banks (through Business Correspondents), Regional Rural Banks (RRBs), Cooperative Banks, Non-Banking Financial Companies (NBFCs) and Microfinance Institutions (MFIs).

Micro Insurance: It is the insurance with low premiums and low coverage. Micro-insurance covers low income/net-worth persons and transactions are of low value. Like normal insurance, it can cover wide range of risks including damage to crops and livestock.

Micro Saving: Micro saving is targeted at people with low incomes and low savings. They are similar to saving accounts, but designed for small deposits. Typically, the limit of minimum deposit/balance is low and there are no service charges.

Microfinance Institutions: Institutions providing Microfinance services are called Microfinance Institutions (MFIs). A large number of organisations with varied size and legal forms offer Microfinance services. The MFIs exist as separate institutions because of the unique features of Microfinance like high transaction costs, short duration of loans, high frequency of repayment/instalments, absence of collateral and relatively higher rate of default.

Types of Microfinance Institutions in India

Joint Liability Groups: JLGs are informal group of 4-10 people that seek mutually assured loans. Agriculture-related loans are typical. Farmers, rural labourers, and renters are among the debtors in this category. JLG members are **equally responsible for loan repayment**.

Self-Help Groups: An SHG is a group of people in similar socioeconomic situations who come together to help each other. They are self-governed. Members come together (often for a limited time) to form a shared fund for their mutual business requirements. This type of cooperative financing does not necessitate the use of collateral. In addition, borrowing rates are often cheap. Several banks have formed partnerships with SHGs in order to **increase financial inclusion** in the country's rural areas e.g., the NABARD-SHG linkage program, allows numerous self-help groups to borrow money from banks if they can show that their borrowers have made regular payments.

Regional Rural Bank Model: The main purpose of this strategy is to boost the rural economy. They have been created to serve rural areas with basic banking and financial services.

Cooperatives: Rural cooperatives were established at the time of India's Independence. Through the cooperatives, resources of the poor are pooled and financial services are made available.

MFIs, based on their set-up, are regulated as NBFCs by the RBI, or through Companies Act, 2013.

Status of Microfinance

According to NABARD, the SHG-Bank Linkage Programme, covers 14.2 crore families through 119 lakh SHGs (87% of which are women) with savings deposits of INR 47,240.48 crore (March 31, 2022).

NABARD has sanctioned a cumulative grant assistance of INR 255.81 crore to Joint Liability Groups Promoting Institutions (JLGPIs) for promoting 12.77 lakh JLGs (March 31, 2022). There are 188 lakh JLGs of which 54 lakh were promoted during FY 2021-22 (as against 41 lakh promoted in FY 2020-21). During FY 2021-22, loan disbursed was INR 112,772.75 crore.

According to NABARD, Microfinance operations in India are spread across 595 districts of 28 States and 5 Union Territories. As on 31 March 2022, the combined micro credit portfolio of 225 lenders is INR 262,599 crores.

The benefits of Microfinance

Credit to Low-Income Borrowers: Microfinance provides credit to the poor people with low income and assets who face difficulty in accessing finance from formal banking institutions. They help in providing funds to small entrepreneurs in poor regions.

Collateral-Free Loans: No collateral is required for Microfinance loans. This helps persons with little or no assets to access credit.

Financial Inclusion: Microfinance helps those sections of population who are unable to access credit from Banks/formal institutions.

Income Generation: Loans provided by MFIs help small entrepreneurs set-up/expand/scale-up their operations. This enables them to improve their income.

Women Empowerment: Microfinance facilities have proven to be vital in providing financial independence to women and thus empowering them. As noted by NABARD Report, SHG-Bank Linkage Programme has benefited 119 lakh SHGs, 87% of which are women. Access to finance will help increase women-led MSMEs.

Rehabilitation: Microfinance is able to provided access to finance in naxal areas as well. It has thus helped in rehabilitation of the conflict-affected people.

Rural Development: Microfinance boosts economic activities in the rural area and thus aids in rural development. It helps create livelihood opportunities as well.

Encourage Self-Sufficiency and Entrepreneurship: MFIs can provide much-needed funds to an individual for the establishment of a new business that requires small investment and offers long-term profit. Thus they promote entrepreneurship and self-sufficiency among the lower-income population.

The challenges associated with Microfinance

Financial Illiteracy: Financial illiteracy leads to lack of awareness about various MFIs, and the services the offer. This makes the poor people reluctant to approach the MFIs.

Inability to Generate Funds: MFIs face difficulty to raise sufficient funds as they are generally not 'for-profit'. This restricts their access to funds from private equity investors or other market-based avenues of funding.

Heavy Dependence on Banks: MFIs are dependent on borrowing from banks. For most MFI's funding sources are restricted to private banks. Funds available from these banks are typically for short term, generally 2 years. Moreover, Banks tend to disburse loans at the end of financial year to meet the targets. This can create issues for MFIs if there is delay in repayment of loans by borrowers.

Weak Governance: Many MFI's are not willing to convert to a corporate structure; hence there is lack of transparency. This also limits their ability to attract capital. MFI's face challenge to strike a balance between social and business goals.

Interest Rate: Some MFIs charge high interest rates, which the poor find difficult to pay. MFIs are private institutions and do not get any subsidized credit for their lending activities. Thus they tend to charge higher interest rate.

Regional Imbalances: There is unequal geographical growth of MFIs and SHGs in India. About 60% of the total SHG credit linkages in the country are concentrated in the Southern States. In poorer regions like in Jharkhand, Bihar etc. where the proportion of the poor is higher, the coverage is comparatively lower. This could be attributed to lack of State government support, NGO concentration and public awareness

Promote Microfinance in India

Government Programmes: **(a) SHG-Bank Linkage Programme** (SHG-BLP): This channel was initiated by NABARD in 1992. This model incentivises women to unite together to form a group of 10-15 members. Women belonging to financial backward classes contribute by giving their individual savings to the group at regular intervals. Loans are provided to the members of the group by their contributions;

(b) Micro Enterprise Development Programme (MEDPs): The programme enables SHG members to be up-skilled to take up income generating livelihood activities. The main objective of the programme is to **enhance the capacities of participants** through appropriate skill up-gradation in existing or new livelihood activities in farm or non-farm activities. It helps enrich knowledge of participants on enterprise management, business dynamics and rural markets;

(c) Livelihood and Enterprise Development Programme (LEDP): It was initiated on a pilot basis in 2015 with a view to **create sustainable livelihoods** among matured SHG members and to obtain optimum benefit from skill up-gradation. LEDP is a holistic intervention mechanism conceived to take care of the entire ecosystem required for livelihood promotion in both farm and off-farm activities. It is implemented through cluster-based approach within contiguous villages. It has a provision for intensive training for skill building, refresher training, backward-forward linkages, handholding and escort support for credit linkage;

(d) Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE): It implements the credit guarantee scheme for Micro and Small Enterprises (MSEs). It has added MFIs to the list of member lending institutions (MLIs).

Financial Support by NABARD and SIDBI: **(a)** NABARD supports MFIs in their formative years (as NGO-MFIs) with grant support and **Revolving Fund Assistance** (RFA). NABARD had also created the **Micro Finance Development and Equity Fund** (MFDEF) in 2006 to help a number of MFIs with quasi-equity and subordinated debt instruments;

(b) SIDBI has aided the growth of MFIs through its **SIDBI Foundation for Micro Credit** (SFMC). The **India Microfinance Equity Fund** (IMEF) of SIDBI has also supported MFIs, especially the medium and smaller ones with equity and quasi-equity. Since IMEF had similar function as MFDEF, it (MFDEF) was withdrawn in 2013;

(c) MUDRA: Support to Microfinance sector was scaled up by Government of India by setting up the **Micro Units Development & Refinance Agency Ltd (MUDRA)** in 2015. It is an NBFC that focuses on micro-enterprises, extending **financial support to MFIs** for on-lending to individuals/groups/JLGs/SHGs.

Regulatory Initiatives: **(a) Y H Malegam Committee**: It was set-up in the wake of AP Microfinance crisis in 2010. It was constituted by the RBI to study issues and concerns in the Microfinance sector;

(b) Introduction of Regulations for NBFC-MFIs: Based on the recommendations of the Malegam Committee, RBI introduced a comprehensive regulatory framework for NBFC-MFIs in December 2011. The regulations prescribed **eligibility criteria for Microfinance loans** linked to core features of Microfinance i.e., lending of small amounts to borrowers belonging to low-income groups, without collateral, and with flexible repayment schedules;

(c) R**egulatory Framework for Microfinance Loans**: RBI has implemented Regulatory Framework for Microfinance Loans, effective from April 1, 2022, to update Microfinance regulatory policy. This will create regulatory parity between Regulated Entities (RE) that provide Microfinance, harmonise regulations to protect customers from over-indebtedness, and define Microfinance. Microfinance loans are now collateral-free loans for households having annual income up to INR 3 lakh.

ADDITIONAL ACTIONS

Regulation: The Microfinance sector has expanded a lot in the last 2 decades. Hence there is a need for a comprehensive regulatory framework for the sector, instead of piecemeal and reactive regulatory initiatives.

Interest Rate Transparency: MFIs are employing different patterns of charging interest rates and a few are also levying additional charges. MFIs should transparently inform the borrowers regarding the interest rate charged on the loans.

Encourage Microfinance Penetration: Encouraging MFIs for opening new branches in areas of low Microfinance penetration by providing financial assistance will increase the outreach of the Microfinance. This will increase **rural penetration** of Microfinance.

Expand Product Range: MFIs should provide complete range of products including credit, savings, remittance, financial advice and non-financial services like training and support. This will enable the people from underserved access all financial services.

Use of Technology: MFIs should use new technologies, IT tools, and applications to reduce operational costs.

Different Sources for Raising Funds: In the absence of sufficient finances, the reach of MFIs becomes limited. MFIs should look for other sources for funding their loan portfolio e.g., by converting to for-profit company (NBFC).

CONCLUSION

The Microfinance sector has played an important role in ensuring inclusive and balanced development. Yet the benefits of Microfinance have been limited to some regions. Moreover, the sector faces issue of rising bad loans along with several operational challenges for the MFIs. There is a need for comprehensive regulation of the sector to make it more inclusive and sustainable.

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