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MICROFINANCE-LEADING TO SUSTAINABLE ECONOMIC GROWTH A STUDY WITH RESPECT TO INDIAN ECONOMY

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Abstract

Microfinance is the provision of financial services to low-income, poor and very poor self employed people. (Otero, 2000)
The concept of micro financing is not new in India. Earlier there were money-lenders who used to provide ready credit to farmers and now there are organized formal institutions like NABARD, SIDBI, Grameen Banks, Regional Rural Banks(RRBs), Co-operatives, Microfinancial Institutions(MFIs) and various Self Help Groups (SHG)which provide micro financing services.
Few years back micro financing was viewed only as a source of providing rural credit to farmers, cottage industries and small scale industries who could not afford the high interest rates of nationalized banks and required very small ticket loans.
However, with the advent of the era of "Make in India" and "Start up India" the role of micro financing is evolving as a medium to provide cheap and easy credit to young entrepreneurs.
The diversification of the clientele of microfinance calls for some radical changes to be made in terms of its network, operations and regulations and introduction of innovative products to suit the requirements of changing times and to make micro financing a prominent tool which can help Indian economy attain a sustainable growth.
The paper begins with the introduction of the conceptual framework of microfinance in India, its growth and types of services offered in the present scenario, followed by structure of Microfinance Institutions (MFIs) in India.
A detailed analysis of the role played by these MFIs and their services in the economic development of Indian economy will be done. The need for sustainable economic growth, challenges faced and the innovative measures to attain the same will be discussed.
Also, the role of NABARD as a facilitator of microfinance will be looked into.
Lastly, the paper focuses on various suggestions to improve the conditions of MFIs and the need for a regulatory body to develop and guide MFIs will be highlighted.
The aim of this paper is to focus on the importance of microfinance as a new tool to stimulate Indian economy to attain sustainable economic growth in the era of skill development and capacity building..

Keywords: Microfinance, Economic Growth, Sustainable Growth, Microfinance Institutions.

Introduction

"Poverty is a situation of pronounced deprivation in well being.(World Bank, 2000-2001) It means those considered as poor lack access to food, shelter, clothing and basic education. They survive on meager income which often exceeds their expenditure. It makes this population highly vulnerable and exposed to unfavorable conditions where it becomes necessary for them to borrow money from money-lenders at high interest rates. This further worsens the situation as they are not able to pay these exorbitant rates and as a result, are caught in a vicious circle of huge amount of unpaid loans. Here comes the need and utility of an institution which could provide cheap and ready credit to these poor people. This is referred to as microfinance.

The National Microfinance Taskforce, 1999, in India has defined microfinance as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards."

Research question

Due to the substantial surge in the area of microfinance and the public attention that it has been receiving, there appears to be a need for a two dimensional research: Firstly, the role of microfinance as tool to accelerate the growth of Indian economy needs to be examined, along with the challenges faced by microfinance institutions. And secondly, various suggestions and improvements to meet these challenges have been discussed. Thus, this paper investigates:

What is the role played by MFIs in the development of Indian economy which could help it attain a sustainable growth, and what are the challenges which needs to be taken care of to ensure smooth functioning of these MFIs? What are the various measures through which these challenges could be met?

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Methodology

As for the analysis of the current situation, the academic literature since 2004, as well as various industry publications have been reviewed in depth.

The approach chosen is purely qualitative due to fact that there is no agreed upon model or indicator to measure the risks inherent in outsourcing activities. A sample of top ten Micro financial institutions (including NABARD, SIDBI, SHGs NBFCs and NGOs) was selected which could sufficiently represent the universe.

The data consists of informal talks and discussions with the concerned people (majorly through references) who provided the requisite information on the condition of anonymity. Also, the information sought has been generalized to maintain the confidentiality of data of individual institutions. For the purpose of the study, references have also been taken from various researches that have been conducted in this field. The most important among them is the Bharat Microfinance Report 2011 by The Association of Community Development Finance Institutions (2011), Sharma and Tewari, Sustainable Financial Services for a Developing Rural Economy: Establishing Needs and Prospects for Growth through Microfinance Institutions (MFIs) (2014) , Report by NABARD, Status of Micro Finance in India (2012), RBI Guidelines on Priority Sector Lending (2016).

Conceptual Framework

The concept of microfinance is not new. However, the credit of institutionalizing microfinance goes to Dr. Yunus who experimented with the concept of Grameen Bank in Bangladesh. The success of this experiment was noticed globally and Yunus, for his efforts, received Nobel Peace Prize in 2006. The model was soon replicated and various institutions on similar lines soon mushroomed around the world. It worked on the principle that “the clients should not go to the bank but rather the bank should come to them.” (Tripathi,Vivek Kumar, 2014)

Microfinance in India

As a part of the poverty alleviation program, microfinance in India, has operated through Self Help Groups(SHGs), Non-Government Organizations (NGOs) and Credit Agencies. But the actual thrust to micro financing initiatives came with the establishment of National Bank for Agricultural and Rural Development (NABARD) in 1992.

Prior to that the initiatives undertaken by various SHGs and NGOs failed to gather a mass momentum primarily due to high dependence of these SHGs and NGOs on donations and grants for their funding. An immediate need to channelize the savings of rural population was felt. For this purpose, ensuring a bank account to everyone was considered as a pre-requisite. This need was fulfilled by establishing specific, structured apex institutions like NABARD, Small Industries Development Bank of India (SIDBI) and Rashtriya Mahila Kosh (RMK).

At the ground level, this responsibility was entrusted to Regional Rural Banks (RRBs) and Co-operatives. Commercial banks were also directed to provide 40% of their lending to priority sector which includes agriculture and allied activities, micro and small enterprises and other low income group for various needs.

There are also some NGOs which lend credit to SHGs. The NGOs that support the SHGs include MYRADA in Bengaluru, PRADAN in Tamil Nadu, SEA in Ahmedabad, SPARC in Mumbai and ADITHI in Patna. Besides this, there are some NGOs that directly provide credit to the borrowers. It includes SHARE in Hyderabad, ASA in Trichy, RDO LOYALAM Bank in Manipur(Tiwari,2004).

Types of MFIs in India

MFIs in India consist of the following-

1. Commercial Banks (including both Public and Private Sector banks)- Commercial Banks are directed by RBI to provide a specified percentage of their total lending to priority sector which includes agriculture and allied activities, small and medium enterprises, housing and education needs of low income group.
2. Regional Rural Banks – These are the local banks which have been set up to cater to the banking and financial services need of the people in rural and semi-urban areas. Their primary function is to ensure banking facilities in rural areas, execution of various Government policies and programs launched for the upliftment of the poor and providing micro credit to the needy.
3. Co-operative banks - Co-operative banks, in India are registered under co-operative Societies Act, 1912.It is a financial entity of likeminded people who come together and pool their capital which is used to provide various banking and financial services for the mutual benefit of the members.
4. Non-Banking Financial Companies (NBFCs)- It is a company registered under the Companies Act whose primary business is to provide financial and other banking services except that it does not have a banking license and is not involved in retail branch banking. It can be called as a MFI which provides loans and advances for profit making. These companies are a major source of funding for startups in India.
5. NABARD, SIDBI and RMK – These are the apex level micro finance institutions in India which provide sustained financial assistance to the rural population. They lend through SHG-Bank linkage program or directly to MFIs/NGOs providing small ticket loans.

Role of Microfinance in Indian Economy

Microfinance has always been an integral part of Indian economy but in today’s scenario its importance has increased manifold as it is looked upon as a new tool to stimulate Indian economy and lead to sustainable economic development. The vital role played by microfinance in Indian economy can be highlighted through the following points:

- Upliftment of the poor – Microfinance acts as a strong mechanism which could meet the initial capital requirement of those who want to expand or start a new venture. Besides, it also acts as a source to provide them an extra income through which people living in rural areas can meet their healthcare needs and children education.
- Generating Employment- Small and micro level business and cottage industries get a huge financial support through micro financing. These businesses, in turn, generate ample employment opportunities. Increase in employment leads to financial stability and give boost to the economy in the form of higher GDP.
- Capacity Building and skill development- With the coming of the era of "Start-up India" and "Make in India" microfinance has gained a new momentum. It serves as a means to build and enhance the income generating capacity of the rural as well as new and young entrepreneurs. The MFIs also support these new entrepreneurs in sharpening their skill set by providing them with the right kind of training and exposure to new ideas.
- Channelizing savings- Microfinance act as an important tool to channelize small savings of poor people by including them into mainstream banking. This way the savings so mobilized can be used to provide easy credit to those in need.

NABARD as a facilitator of microfinance

Since its inception, NABARD has been continuously working towards rural development and rural prosperity in India. Till date it has financed a number of innovative projects on irrigation, agriculture infrastructure and other allied activities. It also focuses on knowledge building and knowledge sharing through Farmers' Club and Selh Help Groups.

Through programs like ARWIND (Assistance to Rural Women In Non-Farm Development) and MAHIMA (Marketing of Non-Farm Products of Rural Women) it is also working towards women empowerment. NABARD is also very active in undertaking various Research and Development initiatives in the field of agriculture and rural development.

Sustainable Economic Growth

Sustainable economic growth can be defined as a balanced growth which ensures economic development of the present generation keeping in view the requirements of the future generations. It requires a long term vision to maintain and conserve natural resources for the generations to come while making judicious and optimum use of the same for the purpose of economic development.

One of the important dimensions of sustainable growth is financial sustainability. This sustainability in the economic development can only be achieved through financial security and financial inclusion of rural India in the mainstream banking. Financial services like credit, insurance, bank accounts etc. should be made accessible to the people living in the remotest of areas. The key to sustainability lies at the bottom of the pyramid. Only when the base is strong the pyramid will be able to sustain itself.

Now, the issue lies as to how to financially include the low income strata in the mainstream. A lot has been done in this direction. However, there are certain challenges which have been observed in the journey so far. These challenges need to be addressed at a priority basis.

Some of these challenges are-

1. **Insufficiency of funds** – The savings of rural people mobilized by MFIs are not enough to meet the growing demand for credit. SHGs and NGOs largely depend on donations and grants form governments, NABARD and SIDBI for their funding. This insufficiency acts as a major bottleneck in the smooth functioning of the MFIs. Also it restricts the autonomy of the MFIs.
2. **Lack of transparency and performance standards**- Different MFIs follow different policies, procedures and performance bench marks. There is no uniformity in their style of working and measuring performance as there is a lack of standardized set of rules for them. As a result, their performances lack transparency, accountability and comparability.
3. **Non-standardized interest rates**- Different institutions charge different rates from different customers for different products. This makes the pricing confusing and difficult for the borrower to understand. Eventually, it reduces their bargaining power.
4. **High operating cost**- Financial inclusion of rural population into mainstream is a costly affair. It involves high operating cost in terms of adequate infrastructure like roads, transport system and communication network. When these requirements are borne by MFIs, their per unit cost increases and the customer to bound to pay a higher rate of interest.
5. **Limited area coverage**- Though microfinance has grown significantly in the past years, there still lies a latent workforce which is still outside the ambit of MFIs and needs to be included.
6. **Untrained Staff**- One of the biggest challenges in the growth of MFIs is the lack of quality staff which could cater to the needs of rural people. The products that are offered to rural people are customized as per the individual's requirement which increases its complexity. For this purpose, the staff needs to be highly competent and well trained.
7. **Risky affair**- Rural involves high credit risk as the rural people do not

have a regular source of income. This is because they are highly dependent on agriculture which in turn is dependent on a number of variables like- weather conditions, market forces, government policies etc. Also, most of the loans disbursed to them are unsecured which leads to high rate of delinquency and default by customers.

8. **Lack of regulatory and legal structure**- MFIs in India today are in dire need of a regulatory and legal framework. They need a centralized body to govern the various MFIs, NGOs and SHGs to protect the rights of various stakeholders.
9. **Lack of awareness amongst rural population**- Every year a number of schemes are launched for poor people but they are not optimally utilized as their target population is highly illiterate and totally unaware about these schemes. This problem of illiteracy also presents a major roadblock in execution and understanding of these schemes.
10. **Politically Driven**- Rural population forms a major part of the vote bank so to lure them, time and again, various schemes are launched at the time of election but unfortunately it remains on paper only. Besides, the schemes which see the light of the day are poorly executed because of corruption and disinterested officers.

Suggestions and Improvements

Long term growth and stability of MFIs is a pre-requisite for a sustainable growth of the economy. The MFIs need healthy and competitive environment to flourish. In the era of skill development and capacity building the challenges cited above restricts the pace of growth. Therefore, these challenges need to be looked into on an urgent basis.

Some of the suggestions and improvements to meet these challenges are listed below-

1. **Alternate mediums of financing**- To meet their funding needs, MFIs should look for alternate modes of financing which could be private equity, NRI funding, bank borrowings at subsidized rates etc. They should also be allowed to accept public deposits.
2. **Increasing transparency and accountability** – Standardized performance standards should be made for the MFIs which require adequate disclosures. This would ensure transparency and accountability. Also, it will lead to uniformity in policies and practices.
3. **Standardization of interest rates**- Too many products with different pricing makes the entire stuff highly complicated for a layman to understand. To simplify the process, interest rates should be standardized. This will not only reduce ambiguity in pricing but also ensure effective comparison and competitiveness.
4. **Provision of infrastructure**- To ensure that MFIs reach the remotest of areas, adequate and proper infrastructure should be put into place.
5. **One Nation, One Network** – A PAN India database and network of all the MFIs functioning currently should be set up. There should be a national call center from where the customer could get all the desired information. Also, various kiosks and help desks should also be placed in the close vicinity of people which can guide them in hour of need.
6. **Trained Quality Staff**- The staff should be well groomed, well trained and highly competent. They should have a rural orientation, willingness and intention to help their rural brethren.
7. **Diversified Portfolio**- To mitigate the risk involved in unsecured rural lending, MFIs should be allowed to lend a certain ratio of their lending to urban borrowers as well. It would ensure a regular sustainable earning for MFIs. Also, various incentives like- waiver of interest or a few EMIs should be provided to ensure timely repayment.
8. **Legal and regulatory framework**- An apex centralized body to regulate and supervise the functioning of these institutions should be formed. It should be enacted by a proper law to give it a legal backing. It should have its own governing body consisting of representative from government, RBI, NABARD and other prominent institutions.
9. **Support beyond credit**- MFIs should come forward and support the poor people not only in meeting their financial needs but also by addressing their social needs-like skill enhancement, financial planning, capacity building, assessing the need for different financial services.
10. **Autonomous status**- A national institute for regulating the working of MFIs, issuing various standards and guidelines from time to time and meeting the training requirements of the personnel involved should be set up by an Act of Parliament. This will ensure an autonomous status and independent functioning of MFIs without any undue political intervention.

Conclusion

In the present times, when the focus of the entire nation is on self-sufficiency and capacity building, micro finance is fast emerging as an important tool to fund the dreams of young entrepreneurs and increase the earning capacity of their rural counterparts. However, with all the positives, microfinance also comes with its set of challenges which should be dealt with in a systematic manner. Only then it will be able to contribute effectively in India's journey to attain sustainable economic growth.

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