



Microfinance Institutions

Why in News

[Microfinance institutions \(MFIs\)](#) have urged the Centre to consider prioritising vaccinations for their employees and [self-help group](#) workers.

- This request is in order to **ensure that lines of credit remain open for the poor** amidst the rising second wave of [Covid-19 infections](#).

Key Points

▪ About:

- MFI is an organization that **offers financial services to low income populations**.
 - These services include **microloans, microsavings and microinsurance**.
- MFIs are **financial companies** that provide **small loans to people who do not have any access to banking facilities**.
 - The definition of “small loans” varies between countries. **In India, all loans that are below Rs.1 lakh can be considered as microloans.**
- In most cases the so-called **interest rates are lower than those charged by normal banks**, certain rivals of this concept accuse microfinance entities of creating gain by manipulating the poor people’s money.
- Microfinance sector has **grown rapidly over the past few decades** and currently it is serving around **102 million accounts** (including banks and [small finance banks](#)) of the poor population of India.
- **Different types of financial services providers for poor people** have emerged - non-government organizations (NGOs); cooperatives; community-based development institutions like self-help groups and credit unions; commercial and state banks; insurance and credit card companies; telecommunications and wire services; post offices; and other points of sale - offering new possibilities.
- [Non Banking Finance Company](#) (NBFC)-MFIs in India are regulated by **The Non-Banking Financial Company -Micro Finance Institutions (Reserve Bank) Directions, 2011** of the [Reserve Bank of India](#) (RBI).

▪ Major Business Models:

- **Joint Liability Group:**
 - This is usually an informal group that consists of **4-10 individuals who seek loans against mutual guarantee**.
 - The loans are usually taken for **agricultural purposes or associated activities**.
- **Self Help Group:**
 - It is a group of individuals with similar socio-economic backgrounds.
 - These small entrepreneurs come together for a short duration and create a common fund for their business needs. These groups are classified as non-profit

organisations.

- The **National Bank for Agriculture and Rural Development (NABARD)** SHG linkage programme is noteworthy in this regard, as several Self Help Groups are able to borrow money from banks if they are able to present a track record of diligent repayments.

- **Grameen Model Bank:**

- It was the brainchild of **Nobel Laureate Prof. Muhammad Yunus in Bangladesh in the 1970s.**
- It has inspired the creation of **Regional Rural Banks (RRBs)** in India. The primary motive of this system is the end-to-end development of the rural economy.

- **Rural Cooperatives:**

- They were established in India at the time of Indian independence.
- However, this system **had complex monitoring structures and was beneficial only to the creditworthy borrowers** in rural India. Hence, this system **did not find the success that it sought initially.**

- **Benefits:**

- They provide **easy credit** and offer small loans to customers, without any collateral.
- It makes **more money available to the poor** sections of the economy, leading to **increased income and employment** of poor households.
- **Serving the under-financed section** such as **women, unemployed people** and those with **disabilities.**
- It helps the poor and marginalised section of the society by making them **aware of the financial instruments available for their help and also helps in developing a culture of saving.**
- Families benefiting from microloans are more likely **to provide better and continued education for their children.**

- **Challenges:**

- **Fragmented Data:**

- While overall loan accounts have been increasing, **the actual impact of these loans on the poverty-level of clients is not clear** as data on the relative poverty-level improvement of MFI clients is fragmented.

- **Impact of Covid-19:**

- It has impacted the MFI sector, with collections having taken an initial hit and disbursements yet to observe any meaningful thrust.

- **Social Objective Overlooked:**

- In their **quest for growth and profitability**, the social objective of MFIs—to bring in improvement in the lives of the marginalized sections of the society—seems to have been gradually eroding.

- **Loans for Non-income Generating Purposes:**

- The proportion of loans utilized for **non-income generating purposes** could be much higher than what is stipulated by the RBI which is 30% of the total loans of the MFI.
- These loans are short-tenured and given the economic profile of the customers, it is likely that they soon find themselves in the **vicious debt trap of having to take another loan to pay off the first.**

Way Forward

- MFIs need to **focus on creating a sustainable and scalable microfinance model** with a mandate that is unequivocal about both economic and social good.

- MFIs should **ensure that the 'stated purpose of the loan' that is often asked from customers at the loan-application stage is verified** at the end of the tenure of the loan.
- **RBI** should encourage all institutions to monitor their impact on society by means of a 'social impact scorecard'.

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