



## Promoting Inclusive Growth through Microfinance

This editorial is based on [“Move microloans to formal sector, be it banks or MFIs”](#) which was published in the Hindu BusinessLine on 05/04/2023. It discusses the evolution of microfinance in India, its impact on women's empowerment and poverty alleviation, and the challenges it faces in the future.

**For Prelims:** Self Help Group Bank Linkage Programme, NABARD, RBI, NCAER, Microfinance Institutions, Financial Inclusion, RBI

**For Mains:** Challenges with Microfinance in India and ways to address the same

A 13<sup>th</sup> century Telugu quatrain **mentions the importance of having a lender, doctor, flowing river and righteous people in a village**, and today microfinance has become the key to fulfilling these essential requirements.

Microfinance has **emerged as a crucial tool for inclusive and sustainable growth in India**. India's vast rural landscape demands a financial ecosystem that is responsive to the needs of communities living in remote areas.

The concept of microfinance **originated from the [Self Help Group Bank Linkage Programme \(SHG-BLP\)](#)** that emerged as a result of an action research project conducted by MYRADA in 1989, commissioned by [Nabard](#). The [Reserve Bank of India's \(RBI\)](#) endeavor to connect informal groups with banks to facilitate micro deposits and loans led to the actualization of SHG-BLP.

The heart of India lies in rural areas, so is the economic engine of India. By bringing about financial inclusion, women empowerment and digital inclusion, **microfinance will play a mighty role in India's emergence as a superpower**.

### What is the State of Microfinance in India?

- Microfinance contributes about **130 lakh jobs and 2% of our GVA**, per a [National Council of Applied Economic Research \(NCAER\)](#) study.
- It has the potential to **reach all the 6.3 crore unincorporated and non-agricultural enterprises**. The RBI **recently defined microfinance as collateral free loans** given to households having annual income up to Rs.3 lakh.
- It is possible to ensure the future of microfinance by transitioning all microloans to the formal sector, such as through banks or microfinance institutions.

### How can Microfinance Contribute India in the Emergence of Economic Superpower?

- **Boosting Entrepreneurship:**
  - Microfinance Institutions (MFIs) **provide small loans to people who do not have access to traditional banking services.** This can help boost entrepreneurship and small business development in India, which is crucial for economic growth and job creation.
- **Financial Inclusion:**
  - MFIs can **help improve [financial inclusion](#) in India by providing access to credit and other financial services** to those who have been excluded from the traditional banking system. This can help people save money, invest in education and healthcare, and start their own businesses.
- **Poverty Reduction:**
  - Microfinance can **help reduce [poverty](#) in India by providing small loans to poor people** who do not have access to formal banking services. This can help them start income-generating activities and improve their standard of living.
- **Empowering Women:**
  - Microfinance can also **play a crucial role in empowering women in India.**
  - Women often have limited access to financial resources and are disproportionately affected by poverty.
  - By providing them with access to credit and other financial services, microfinance can help women become more economically independent and improve their social standing.
- **Supporting Rural Development:**
  - Microfinance can **also support rural development in India by providing small loans to farmers and other rural entrepreneurs.** This can help improve agricultural productivity, create jobs, and support overall economic development in rural areas.

## What are the Challenges with Microfinance in India?

- **Over-Indebtedness:**
  - One of the **major challenges with microfinance in India is the issue of over-indebtedness**, where borrowers are unable to repay multiple loans taken from different microfinance institutions.
  - This can **lead to default, which impacts the creditworthiness of the borrower**, and in some cases, results in suicide.
- **High-Interest Rates:**
  - Microfinance institutions charge high-interest rates due to the high cost of servicing small loans. This can **create a debt trap for the borrowers and make it difficult for them to repay the loan.**
- **Lack of Financial Literacy:**
  - Most of the microfinance borrowers in India are from rural areas and are often illiterate or have low financial literacy. This can make it difficult for them to understand the terms and conditions of the loan, leading to misunderstandings and disputes.
- **Infrastructure Challenges:**
  - Microfinance institutions **operate in remote and rural areas, where infrastructure is often lacking.** This can lead to difficulties in communication, transportation, and accessing financial services.
- **Political Interference:**
  - Political interference in the functioning of microfinance institutions can impact their effectiveness and create an unfavorable environment for them to operate.
- **External Shocks:**
  - Microfinance borrowers are **often vulnerable to external shocks, such as natural disasters, economic downturns, and pandemics.** These shocks can impact their ability to repay the loan, leading to default and financial stress.
- **Lack of Regulation:**
  - While microfinance institutions are regulated by the Reserve Bank of India, **there is a lack of regulation at the state level.** This can lead to inconsistencies in the functioning of microfinance institutions across different states in India.

## What Should be the Way Forward?

- **Strengthening the Regulatory Framework:**

- The Reserve Bank of India (RBI) should **continue to monitor and regulate the microfinance sector** to ensure that it operates in a fair and transparent manner.
- The RBI should also consider introducing regulations that address the high-interest rates charged by Microfinance Institutions (MFIs).
- **Promoting Financial literacy:**
  - There is a **need to increase financial literacy among microfinance borrowers** to help them make informed decisions about borrowing and repayment.
  - MFIs should conduct financial literacy programs regularly to educate their clients about savings, credit, insurance, and investment.
- **Encouraging Innovation:**
  - The microfinance sector in India should **encourage innovation in product development, delivery mechanisms, and technology adoption**. The use of technology such as mobile banking and digital lending platforms can help in expanding access to financial services and lowering the cost of delivery.
- **Promoting Partnerships:**
  - The government, MFIs, and other stakeholders **should work together to promote partnerships** that can help in addressing the challenges faced by the sector. For instance, partnerships between MFIs and banks can help in providing better financial services to microfinance clients.
- **Addressing the Issue of Over-Indebtedness:**
  - Over-indebtedness is a major concern in the microfinance sector. To address this issue, there is a **need to develop a credit information system that can track the borrowing history of microfinance clients** and prevent them from borrowing beyond their capacity to repay.
- **Ensuring Social Impact:**
  - Microfinance should be seen as a tool for poverty reduction and social empowerment. The sector should focus on delivering positive social impact by providing financial services to the poorest and most vulnerable sections of the population.

### **Drishti Mains Question**

What are the challenges faced by microfinance institutions in India and how can they overcome these challenges to effectively serve the financial needs of the country's low-income population?

## **UPSC Civil Services Examination, Previous Year Question (PYQ)**

### **Prelims**

**Q. Microfinance is the provision of financial services to people of low-income groups. This includes both the consumers and the self-employed. The service/ services rendered under microfinance is/are (2011)**

1. Credit facilities
2. Savings facilities
3. Insurance facilities
4. Fund Transfer facilities

**Select the correct answer using the codes given below the lists:**

- (a)** 1 only
- (b)** 1 and 4 only
- (c)** 2 and 3 only
- (d)** 1, 2, 3 and 4

**Ans: (d)**

- Microfinance, also called microcredit, is a type of banking service that is provided to unemployed or low-income individuals or groups, who otherwise would have no other access to financial

services.

- Microfinancing organizations support a large number of activities that range from providing the basics like bank checking and savings accounts, loans for small business entrepreneurs, fund transfer facilities and some organizations also provide micro-insurance Products.
- Ultimately, the goal of microfinance is to give impoverished people an opportunity to become self-sufficient.
- Therefore, option (d) is the correct answer.

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