

**MICROFINANCE: THE ONLY ONE-STOP SOLUTION FOR
INEXPENSIVE CREDIT TO THE MARGINALISED IN INDIA: AN IN-
DEPTH ANALYSIS OF THE DIFFERENT BUSINESS MODELS IN
OPERATION AND THEIR SUCCESS**

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DOI: 10.46609/IJSSER.2024.v09i02.011 URL: <https://doi.org/10.46609/IJSSER.2024.v09i02.011>

Received: 10 Feb. 2024 / Accepted: 20 Feb. 2024 / Published: 29 Feb. 2024

ABSTRACT

The paper analysed the strengths and the weaknesses as well as the requirement of MFIs in developing economies like India. It also used primary data to indicate the increasing disbursement of finance through this medium to women and laggard states of India. Regulatory norms by the RBI have effectively resulted in reducing the disbursal rate of interest by private MFIs as well as enforcing strict audit norms. The increasing use of this source of finance has been enhanced by the adoption of UPI.

Keywords: Demographic Dividend, SHGs(Self Help Groups), MFIs(Microfinance Institutions)

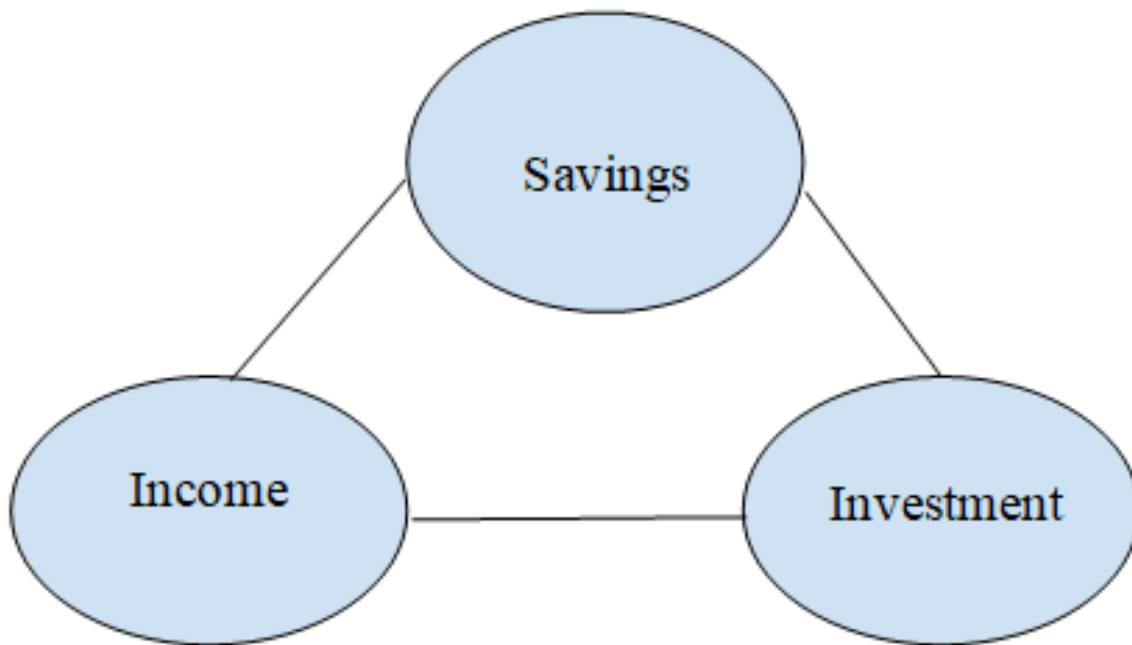
Research question: An attempt would be made to understand the needs of the marginalised population in India concerning being self-employed. How important is credit in achieving employment status? What are the impediments to the availability of funds? Has the Indian government over 75 years been able to achieve some breakthrough in this aspect? How important is self-employment for India to reap the benefits of the demographic dividend? What are alternate sources of funds that are available for the marginalised population? These and other related questions would be attempted to be addressed during research.

Introduction

In developing economies like India, the main reason for the lack of adequate growth is the lack of funds. The Indian economy has been grappling with various methods to try and solve this important issue. It is important because the major two challenges since Independence have been poverty and unemployment.

As the economy underwent major reforms in 1991 this resulted in higher gross domestic product(GDP) than the earlier period. But what has also occurred is the increasing inequality between the rich and the poor. To move out of this poverty cycle the poor have to increase their savings which can increase investment and thus their incomes but as their incomes are barely adequate to meet their current consumption the question of savings does not arise. For most of the marginalised to increase their income, they start depending on other sources of finance. It is amongst this that microfinance has become important.

Figure 1: Relationship between income, savings and investment



Source: author

Origin of Microfinance:

Microfinance was institutionalised by Mohammed Yunus in 1976 with the foundation of the Grameen Bank in Bangladesh. He surveyed the slum community of Jobra for opportunities to help the disadvantaged. Low-income villagers in Jobra had no opportunity to obtain credit. The main reason was that they had no means of physically reaching a conventional bank. Even if they had affordable transportation, banks would never make loans to people without assets or credit history. The only alternative available to the villagers was to use moneylenders who would charge exorbitant interest rates.

Figure 2: Image of Mohamed Yunus interacting with ladies from Jobra



Source: IslamiCity

His model Grameen(Rural) Bank of Bangladesh was based on five groups of borrowers who met regularly with Grameen Bank field managers. His basic foundation for the bank was to provide small loans to individuals with no collateral to non-traditional borrowers such as the poor in rural or undeveloped areas. He observed that a significant percentage of the world's population had been barred from acquiring the capital necessary to rise out of poverty.

This bank's approach is because the small loans were guaranteed by members of the borrower's community. This meant that the collateral was guaranteed by other members of the village. There was pressure within the group which encouraged borrowers to pay back the loans on time. Grameen's clients were the poorest of the poor, many of whom had never possessed any money as we know it and they relied on a barter economy to meet their daily needs. Using this concept of microloans from the bank, borrowers were able to purchase livestock or start their own businesses. By 1996 Grameen had extended credit to more than 3 million borrowed and it had over a thousand branches. Mohamed Yunis was awarded the Nobel Prize in 2006. The success of this institution led it to be copied in Indonesia, Mexico and other underdeveloped economies.

It started with the village of Jobra in Chittagong in the early 1970s with a group of women borrowing 27\$ to finance the group's own small business. The women repaid the loan and were able to sustain the business. Those who received micro-credit did not have money to purchase the material they needed to make the bamboo stools which they wanted to sell. Each borrower would be a risky proposition if they were to lend on their own but by being a part of the Grameen Bank the borrowing took place as a group and this initial finance gave them the required resources to start production. This was with the understanding that the loan would be paid over time as they brought in revenue. It took only a few years for this model to cross both local and international boundaries. The model received recognition for not only being an important

instrument in the reduction of poverty but also the formalisation of micro-credit and its potential in the global finance industry.

It is the transition from micro-credit (this is a common form of microfinance that involves an extremely small loan given to an individual award to help them become self-employed or even grow into a small business. These borrowers tend to be low-income individuals mainly from less developed countries. It is also known as “micro-lending” or “micro-loan”. These schemes rely on a group borrowing model.) To microfinance (This is financial services that are offered to individuals of lower socio-economic backgrounds or those who do not have access to traditional financial institutions. They include several services like savings accounts, checking accounts, fund transfers micro-insurance and micro-credit) and the financialisation of microfinance (this refers to an increase in size and the importance of a country’s financial sector relative to the overall economy.) Its development has changed the structure and operation of financial markets which has resulted in numerous non-profit institutions being converted into profitable businesses.

Marginalised Workers in Overpopulated Economies

In economies that are overpopulated like India, there are always major goals that need to be met concerning the problem of unemployment. This depends on the definition of unemployment that is used by most government statistical organisations. Unemployment is a situation where a person is actively looking for a job and is unable to find work. The unemployment rate is the measure of unemployment in an economy. National and local governments endeavour to offer employment opportunities to certain people who meet the eligibility criteria set by them. Usually, work is available for groups of individuals upon a fixed minimum wage sufficient for bare survival and provides further chances for them to find permanent jobs.

It is a major economic criterion because it shows the capability or the incapability of healthy educated and willing individuals to gain a livelihood. People unable to work for various reasons such as retirement, disability, or pursuing higher education are excluded from this. The higher the country’s unemployment rate indicates an economic growth which is less productive. A high unemployment rate is a significant indicator of financial distress in a country, with social or political ramifications leading to a degeneration of the internal structure.

A low unemployment rate on the other hand signifies maximum use of available labour in an economy, higher wage growth and an overall increase in living standards. An ideal state for the economy is to have maximum output from its potential workforce. Unemployment is broadly divided into two categories:-

1. **Voluntary:** This refers to an individual's decision to leave previous employment and look for other forms of work out of their own choice with no external circumstances.

2. Involuntary: When an individual loses their job due to various reasons.

Causes of unemployment:-

1. Frictional unemployment: This is when people are searching for a better job and is likely to be voluntary.
2. Structural unemployment: In this case, people's skills, income and expectations do not match with the jobs available.
3. Cyclical unemployment: This refers to the periodic rise and fall in the unemployment rate as the economy undergoes the cycle of boom and trough.
4. Institutional unemployment: These occur due to socio-economic reasons like government policies of minimum wages, oppressive job licensing laws, discrimination of hiring workers on racial, religious and other basis and labour market institutions like high trade union activities.

Amongst the above structural unemployment requires more work and a better long-term solution. This unemployment is a very deep-rooted problem. To make this section of society employment-worthy requires investment by the public and private sectors in skill training and education. Reduction in illiteracy, language proficiency, child care expenses, and investment in safe drinking water such that the health of the family is safeguarded.

Unemployment is a huge problem for any economy as it gives birth to poverty both at the individual to national levels. Poverty further diverts focus from education and living well to just earning money. The status of such individuals tends to be exploited by the 'haves' further leading to lower wages.

The people who come under the category of 'have nots' in most economies of the world tend to be the marginalised sections in a society.

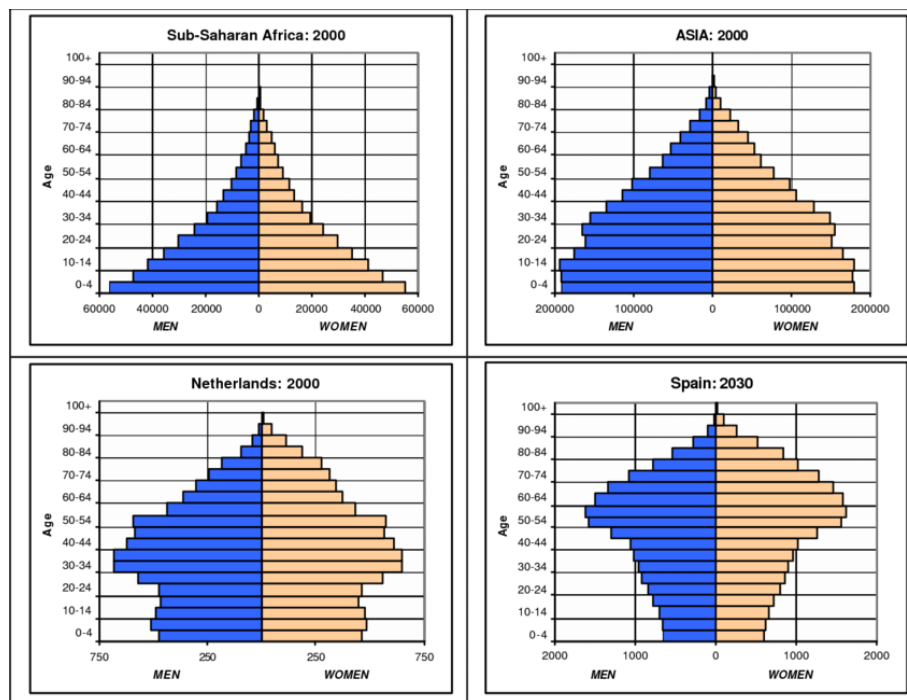
Demographic Dividend

Most countries of the world understand that the population of the economy follows the theory of demographic transition. All economies of the world follow the three stages in the process of understanding demographic transition. The first phase is where the economy faces a high birth rate and high death rate. At this point, the rate of growth of the population may be negative or very nominal. The second stage is one where the economy has a high birth rate and low death rate. This is the time when there is an ever-increasing growth of the population. The third stage is one where the economy has a low birth and death rate. At this stage, the rate of growth of the

population may be nominal or else it will reach replacement rate wherein the birth rate is equal to the death rate or negative rate of population growth. Most countries of the world have reached the third stage of the theory. India has also reached the third stage in the 21st century. Its population growth rate has not reached the replacement rate as yet. However, the rate of growth of the population has been declining.

In the early stages of development, when the economy is in the first stage the population growth can be depicted in the form of a pyramid where the bottom and the top consist of the dependent population and the middle is the independent population. The bottom is the age group 0-15 and the top is 60 and above.

Figure 2



Source: Age pyramids for countries at different stages of the . . . (n.d.). Retrieved from https://www.researchgate.net/figure/Age-pyramids-for-countries-at-different-stages-of-the-demographic-transition-Source-UN_fig6_27451997

India presently has an independent population which is the maximum number in the world. It is necessary to take advantage of this demographic structure and earn a dividend out of it. The manner in which this can be achieved is to have maximum employment of the independent population such that their earning capacity increases and subsequently their savings and investment.

Given the fact that they are inadequate with respect to the number of independent workforce, it becomes necessary to increase the self-employment opportunities and skills for them. As India is also facing problems of poverty, lack of adequate skills, and issues in healthcare for the poor it is important for the government to adequately address the above problems. Along with these, to encourage self-employment it is necessary that the marginalised have access to credit. As these citizens are not eligible for loans from banks as they require collateral and these individuals do not have them. It becomes important to put into place a system where credit becomes available without any collateral. Microfinance then plays an important role in the upliftment of the marginalised.

Microfinance in India

Based on the Grameen Bank Model, there are microfinance institutions that provide small loans to people who do not have access to banking facilities. In India, all loans below rupees 1 lakh are considered microloans. The growth trajectory of microfinance in India has been remarkable and transformational. It has emerged as a potent instrument for diminishing poverty, supporting marginalised segments, advancing women's empowerment and nurturing the upliftment of the rural ecosystem. This segment has expanded rapidly in India over the past 20 years. These services are distributed through a diverse array of financial entities including scheduled commercial banks, regional rural banks, Self-help groups, cooperative banks and NBFCs.

One of the pioneers of this system was the Self Employed Women's Association(SEWA) which demonstrated the potential of microfinance for empowering women and catalysing economic growth as well as protecting and safeguarding the heritage of 'Chikankari'. These women had the skills but did not have the finances or the marketing techniques for their products. SEWA helped them with both.

Rural women from low-income households are often starved of finance in overpopulated developing countries like India. There is a paucity of funds in such economies. Financial institutions want to safeguard their companies by minimising risk. They then only loan funds to those that have adequate collateral, resulting in the poor who are high-risk and high-cost clients being completely out of their ambit.

Microfinance breaks this as it helps low-income households stabilise their income flows and save for future needs. In good times micro-finance helps families and small businesses to prosper and at times of crisis helps them to cope and rebuild.

The microfinance companies themselves need capital such that they are in a position to lend to the marginalised. Asian Development Bank provides microfinance institutions in Indonesia, India, Cambodia etc.

Importance of self-employment in increasing GDP

As microfinance is a very important weapon in reducing a country's poverty level it is important that the government has proper rules and regulations to monitor these companies. Many group-based models promote microfinance in India as they believe that it will help poor people out of poverty. For some, it is a way for the poor to manage their finances more effectively and take advantage of economic opportunity while managing risk. Before the Indian economy globalised in 1990, poor people resorted to the unorganised sector for any requirement for finance. This unorganised sector charged an extremely high rate of interest to the poor and more often than not left them further in debt. The concept of microfinance, especially for countries like India is a tool for socio-economic upliftment. It is an essential aspect for reduction in poverty, increase in income and subsequently, savings, investment and GDP. The important features of microfinance are:-

- It is an essential part of rural finance.
- It deals in small loans
- Caters to poor households.
- One of the most effective and warranted poverty alleviation strategies.
- Supports women participation
- Provides incentives to grab self-employment opportunities
- Assists small entrepreneurs and producers
- Poor borrowers are rarely defaulters in the repayment of loans as they are simple and god-fearing.

Models of microfinance:-

1. **Grameen Model:** in this model, a compulsory contribution has to be made by all members of the cooperative. Loans are normally provided for a period of six months to one year and repayment has to be made on a weekly basis.
2. **Joint Liability Group:** the groups are of 4-10 members who avail of a bank loan against mutual guarantee. All members are jointly responsible for repayment. The extent of empowerment in this model is limited.

3. Individual Lending Model: this is more successful for more large, urban-based, production-based businesses.
4. Group approach: this has 10-20 members who have regular savings that are pooled into a common fund. The loans are issued by financial institutions in the name of the group. The repayment is made to the field staff who visit and monitor the process of repayment. This is known as SHG (Self Help Group) bank linkage which is a very popular model being followed.
5. Village banking model: a village bank is developed by forming 30-100 members who have no income and seek to improve their livelihood. The initial capital of such a bank is provided by financial institutions that further lend money to the members. Loan Amounts are linked to the aggregate amount saved and are repaid in weekly installments.

Challenges of MFIs(microfinance institutions) and regulations by RBI

There have been a number of crises in some of the microfinance companies that have defeated the purpose of its original inception. The Reserve Bank of India known as the Malegam Committee analyzed the flaws and recommended regulations that have to be strictly followed when any microfinance company is set up. This committee recommended that the interest rates charged by MFIs should be reasonable and affordable for the borrowers. It suggested that the margin cap(difference between the cost of funds and the lending rate) should not exceed 10%. This committee which was set up in the year 2018, was constituted to regulate MFIs in India due to the rising incidents of fraud. Besides a cap on interest rates, it recommended regular audits as well as the classification of bad loans.

Challenges faced by microfinance that have to be addressed are:-

1. Over-indebtedness
2. Higher interest rates in comparison to mainstream banks
3. Widespread dependence on the Indian Banking System
4. Lack of awareness of financial services in the economy
5. MFIs which are private institutions have to be economically sustainable and they need to recover their operational cost from borrowers.
6. Unhealthy competition
7. Political unawareness

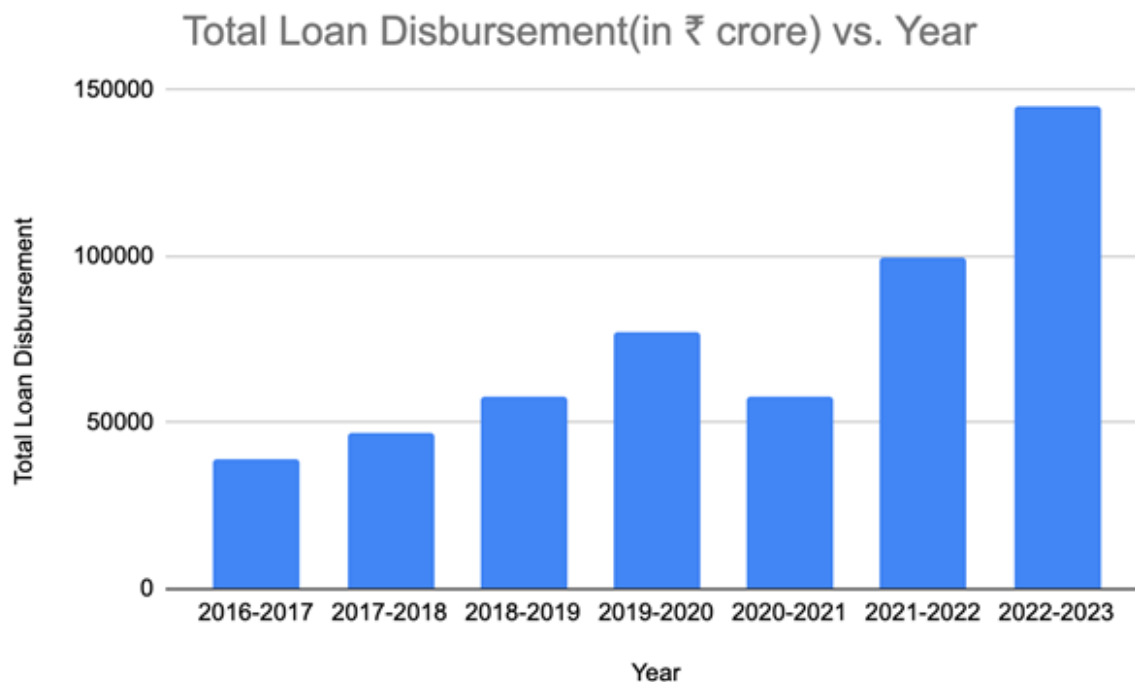
8. MFIs tend to exclude vulnerable groups which threaten the original concept of microfinance.

Some of the factors that affect the financial performance of microfinance are:-

- Operational Efficiency
- Capital Levels
- Liquidity Risk
- Credit Size
- NPAs(Non-performing assets and bad loans)

Role of Disbursement of finance under SHG Bank-Linkage Program from 2016-2023(all figures have been sourced from NABARD)

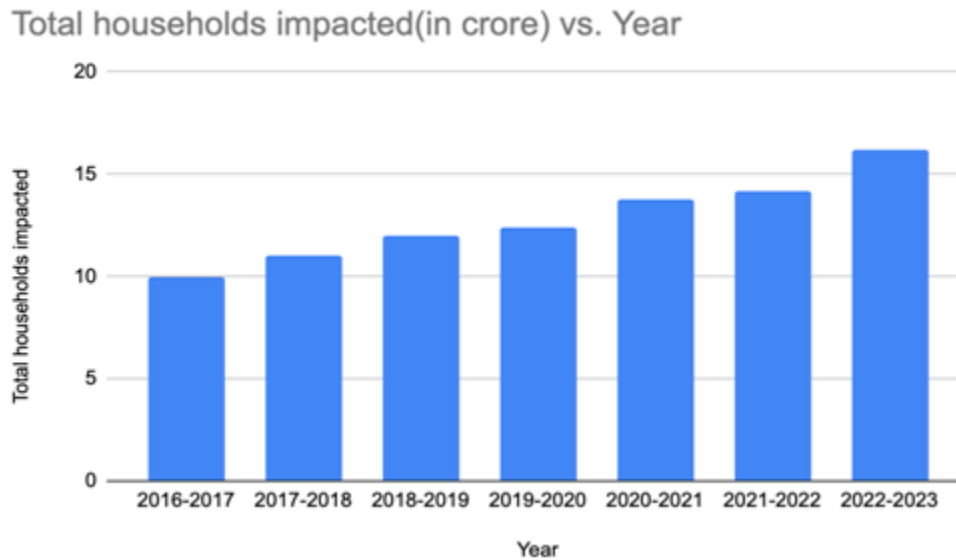
Figure 3: Year-wise total disbursement



Source: NABARD Status of Microfinance in India Reports,

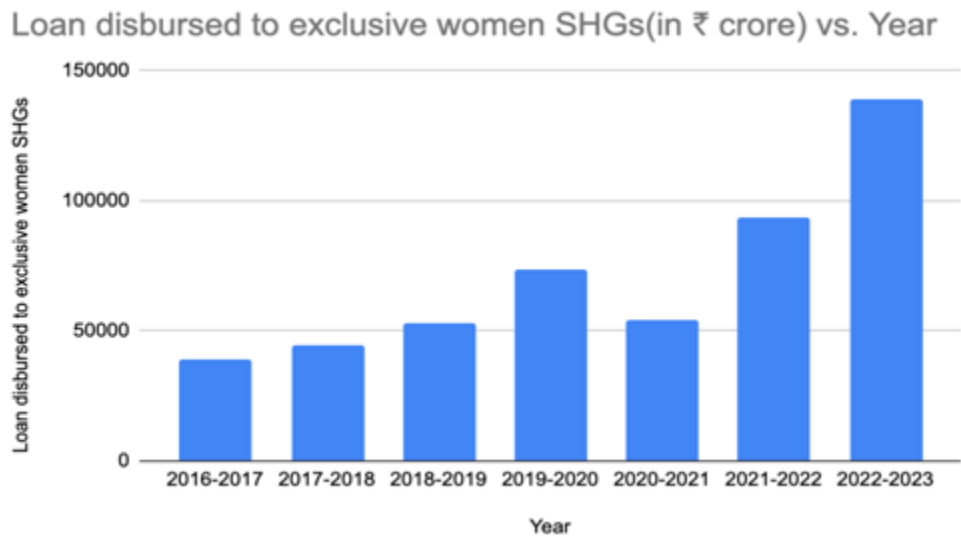
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Figure 4: Total Households impacted by SHG Bank Linkage Program



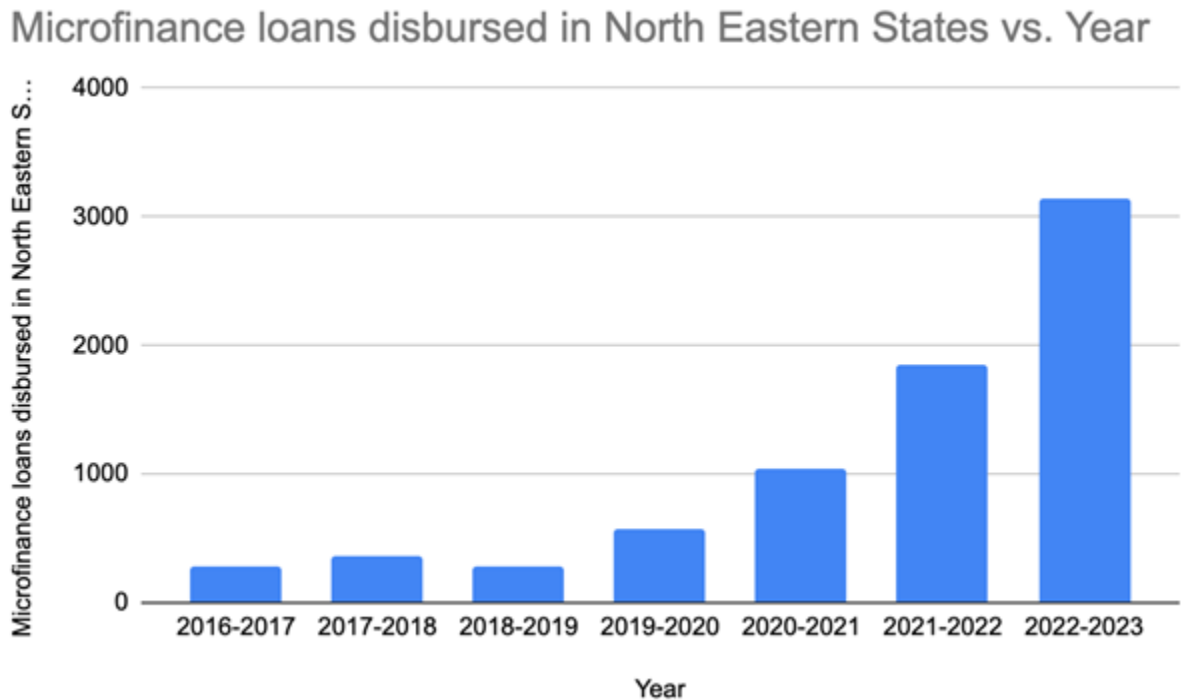
Source: NABARD Status of Microfinance in India Reports
Tabulated by the author

Figure 5: Total loan disbursed to exclusive women SHGs



Source: NABARD Status of Microfinance in India Reports
Tabulated by the author

Figure 6: Total loans disbursed to North Eastern States



Source: NABARD Status of Microfinance in India Reports
Tabulated by author

Analysis of the above data:

- The total loan disbursement has been steadily increasing except for the pandemic year of 2020-2021.
- The total households who have received funds from MFIs have also been steadily on the rise.
- Analysing the exclusive disbursement to Self Help Women's groups: except for the pandemic year of 2020-2021 it has been increasing. Clearly indicating the importance of women in MFIs
- The extent of disbursal of loans to the North Eastern states has been increasing except a minor blip in 2018-2019 from 2016 onwards indicating that the government is keen to harness the potential capability of enhanced per capita income of these states.

Conclusion

MFIs are an extremely important source of finance for the marginalised who do not have collateral such that they can avail loans from regular banks. The model was started by the Nobel Laureate Mohammed Yunus in the form of Grameen Bank in Bangladesh. The original model achieved immense success which led it to being adopted in a number of developing nations. As the number of MFIs increased in developing economies, primarily by private institutions it was discovered that they were charging exorbitant rates of interest which went against the basic tenet of the original model. This led to the setting up of committees like the Malegam Committee in India by the Central Bank to cap the interest rates of disbursement of loans as well as strict audit rules. The result of this has been an increased disbursement of loans to women as well as in deficient states like the North Eastern states of India. This has been enhanced in recent years by ensuring every individual male or female who is entitled to a benefit has a bank account. The increasing use of UPI(Union Payments Interface) has further strengthened the beneficiaries of microfinance institutions.

Attempts have to be continuously made to strengthen this sector such that loans are disbursed at interest rates which are close to the ones that nationalised banks provide.

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