



Financial Inclusion An Microfinance: Opportunities And Challenges

Komal Rathi

Research scholar

C.M.P DEGREE COLLEGE , UNIVERSITY OF ALLAHABAD

Abstract

This research paper aims to explore the role of microfinance in promoting financial inclusion, poverty alleviation, and economic development. Through a comprehensive review of existing literature and an empirical analysis of relevant data, the study will assess the effectiveness of microfinance initiatives in providing access to financial services for the underserved and marginalised populations.. Financial inclusion plays a vital role in driving social and economic advancement in developing nations. At the micro level, it enables impoverished households and small businesses to generate income, accumulate assets, maintain stable consumption patterns, and effectively manage risks. Moreover, an inclusive financial system empowers governments to execute social policies more efficiently in critical areas like education and healthcare by enabling targeted financial transfers. In rural India, women from impoverished backgrounds face limited access to institutional credit due to the high administrative costs and lending risks associated with small loans. To address this issue, microfinance has been adopted as a solution. The research will also examine the socio-economic outcomes of microfinance interventions and their potential to empower individuals and communities in low-income regions This study also aims to analyse the role of microfinance in fostering financial inclusion within this context.

Key words: microfinance , financial Inclusion , socio- economic empowerment.

1. Introduction

In a 13th-century Telugu quatrain, it was emphasised that a village's prosperity depends on having a lender, doctor, flowing river, and righteous people. Today, microfinance has evolved into the key to fulfilling these essential requirements. Microfinance has become a vital tool for promoting inclusive and sustainable growth in India. Given the vast rural expanse of the country, there is a pressing need for a financial ecosystem that caters to the specific needs of communities residing in remote areas. The concept of microfinance traces its roots back to the Self Help Group Bank Linkage Programme (SHG-BLP), which originated from an action research project initiated by MYRADA in 1989, commissioned by Nabard. The Reserve Bank of India (RBI) took the initiative to connect informal groups with banks, facilitating micro deposits and loans, which brought the SHG-BLP program to life. India's economic heart resides in its rural areas, making them the engine of the nation's growth. Through promoting financial inclusion, empowering women, and fostering digital inclusion, microfinance will play a significant role in India's journey towards becoming a superpower.

1.1 Evolution of Microfinance in India

The evolution of microfinance in India has been a significant journey marked by various phases and developments. Here is an overview of the key milestones in the evolution of microfinance in the country:

- ❖ **Informal Systems (Pre-Independence):** Before Independence, informal systems of lending, such as moneylenders and local community groups, were the primary sources of credit for rural communities. However, these sources often charged high-interest rates and exploited borrowers.
- ❖ **The Cooperatives Era (Post-Independence):** After Independence, the government focused on setting up cooperative credit institutions to provide financial services to rural areas. While this initiative aimed to address financial inclusion, it faced challenges such as inefficiency and politicisation.
- ❖ **Nationalisation of Banks (1969):** In 1969, the Indian government nationalised major banks to ensure financial inclusion and increase credit flow to priority sectors, including agriculture and small-scale industries. This move aimed to support rural development and alleviate poverty.
- ❖ **Self-Help Groups (SHGs) (1980s):** The 1980s saw the emergence of Self-Help Groups (SHGs) as a community-based approach to financial inclusion. SHGs are small, informal groups of individuals, usually women, who pool their savings and provide loans to each other at reasonable interest rates.
- ❖ **Linkage with Banks (1990s):** In the 1990s, the concept of linking SHGs with formal banks gained momentum. Organisations like NABARD (National Bank for Agriculture and Rural Development) played a crucial role in promoting the SHG-Bank Linkage Programme. This initiative facilitated access to formal credit for SHGs and paved the way for microfinance in India.
- ❖ **Emergence of Microfinance Institutions (MFIs) (Late 1990s and 2000s):** In the late 1990s and early 2000s, microfinance institutions (MFIs) started to emerge in India. These specialised institutions provided microloans to poor and marginalised communities, often without requiring traditional collateral.
- ❖ **Regulatory Framework (2000s):** The growth of MFIs led to the need for a regulatory framework. In 2011, the Reserve Bank of India (RBI) issued guidelines for the regulation of Non-Banking Financial Companies - Microfinance Institutions (NBFC-MFIs). This brought more formalisation and oversight to the microfinance sector.
- ❖ **Andhra Pradesh Crisis (2010):** In 2010, the microfinance sector faced a crisis in Andhra Pradesh due to aggressive lending practices and over-indebtedness. The state government enacted stringent regulations, impacting the microfinance sector. However, the crisis also led to discussions about responsible lending practices and client protection.
- ❖ **Continued Growth and Diversification:** Despite the challenges, the microfinance sector in India has continued to grow and diversify. New players, including Small Finance Banks (SFBs) and Payments Banks, have entered the microfinance space, further expanding financial inclusion in the country.
- ❖ **Focus on Digitalization:** In recent years, there has been an increasing focus on digitalization in the microfinance sector. Digital financial services, mobile banking, and fintech innovations have improved accessibility and efficiency, making financial services more accessible to the underserved population. The evolution of microfinance in India has been a transformative journey, moving from informal systems to formal institutions, with a growing emphasis on responsible and inclusive financial services. The sector continues to evolve, playing a vital role in promoting financial inclusion and socio-economic development in the country. Financial inclusion plays a pivotal role in achieving inclusive growth, aiming to empower impoverished, underprivileged, and low-income households in both rural and urban areas. Amartya Sen (2000) made a compelling case that poverty is not solely about inadequate income; it also involves the absence of various capabilities, such as security and the ability to participate in economic and political spheres. Financial inclusion is intended to address these limitations by providing equal opportunities for economically and socially marginalised individuals, enabling them to participate and contribute to society effectively.

1.2 Empowerment of Women

The empowerment of women plays a pivotal role in achieving meaningful and sustainable gender equality. It is a socio-political ideal encompassing concepts of dignity and equality, firmly grounded in the broader framework of women's rights. This process involves gaining control over oneself, resources, and challenging existing societal perceptions and attitudes. True empowerment occurs when women's conditions improve, and their positions advance, resulting in expanded economic, social, and political freedoms and choices. The National Policy for the Empowerment of Women in 2001 perceives empowerment as an enabling process that should lead to both economic and social transformation. To bring this approach to life, the government has employed legislative and programmatic interventions and integrated gender considerations into the development planning process. Numerous initiatives were launched during the Eleventh Plan period, and it is essential to consolidate and build upon these efforts during the Twelfth Five Year Plan. By doing so, women will gain the ability to challenge and transform the environments in which they live.

2. Objectives

- ❖ To explore the Role of microfinance in the Indian Economy.
- ❖ To assess the Role of microfinance and financial inclusion in India

3. Research methodology

The present study is based on secondary data. data was collected from various books, journals and newspapers. Both descriptive analysis and inferential analysis have been attempted to throw more light on the study.

4. State of Microfinance in India

- ❖ According to a study conducted by the National Council of Applied Economic Research (NCAER), Microfinance contributes to approximately 130 lakh jobs and accounts for 2% of our Gross Value Added (GVA).
- ❖ Microfinance holds the potential to reach all 6.3 crore unincorporated and non-agricultural enterprises. Recently, the Reserve Bank of India (RBI) defined microfinance as collateral-free loans provided to households with an annual income up to Rs. 3 lakh.
- ❖ Ensuring the future sustainability of microfinance can be achieved by transitioning all microloans to the formal sector, such as through banks or microfinance institutions.

5. Contribution of microfinance India

Microfinance has emerged as a powerful tool to address financial exclusion, providing small loans, savings, and insurance products to individuals who are often excluded from traditional banking services.

- ❖ **Boosting Entrepreneurship:** Microfinance Institutions (MFIs) extend small loans to individuals without access to conventional banking services. This can foster entrepreneurship and the development of small businesses in India, a crucial factor for promoting economic growth and generating employment opportunities.
- ❖ **Financial Inclusion:** Microfinance institutions (MFIs) have the potential to enhance financial inclusion in India by offering credit and various financial services to individuals who have been marginalised by the conventional banking system. This expanded access can empower people to save funds, invest in education and healthcare, and initiate their entrepreneurial ventures.

- ❖ **Poverty reduction :** Microfinance has the capacity to alleviate poverty in India by extending small loans to underprivileged individuals who lack access to formal banking services. Such financial support enables them to embark on income-generating ventures, ultimately leading to an enhancement in their quality of life.
- ❖ **Empowering Women:** Microfinance holds a significant role in empowering women in India. Due to limited access to financial resources, women are disproportionately affected by poverty. By granting them access to credit and various financial services, microfinance can facilitate their economic independence and enhance their social status.
- ❖ **Supporting Rural Development:** Microfinance can contribute to rural development in India by offering small loans to farmers and other rural entrepreneurs. This support can lead to enhanced agricultural productivity, job creation, and overall economic development in rural regions.

6. Microfinance: The financial inclusion enabler

Financial inclusion refers to providing individuals with access to suitable, affordable, and responsible financial products tailored to their specific needs. It encompasses a range of financial services, including deposits, digital payments, lending, and insurance. In the past, low-income households and MSMEs faced limited access to credit, leading them to resort to informal lenders who imposed excessively high interest rates. However, with the widespread adoption of microfinance, barriers to formal lending and economic loan products have been dismantled.

According to the latest Financial Inclusion (FI) Index released by the RBI, there has been significant improvement, with the index rising to 56.4 in FY22 from 53.9 in FY21. This indicates that individuals at the lower end of the socioeconomic spectrum are now benefiting from increased access to loans, which can contribute to their long-term income and wealth generation.

7. Current status of microfinance in india

Based on NABARD's data, as of March 31, 2022, the SHG-Bank Linkage Programme has provided coverage to 14.2 crore families through 119 lakh SHGs, with an impressive 87% of these SHGs being women-oriented. The total savings deposits in these SHGs amount to INR 47,240.48 crore. Additionally, NABARD has granted cumulative financial assistance of INR 255.81 crore to Joint Liability Groups Promoting Institutions (JLGPIs) to promote 12.77 lakh JLGs by the same date. Overall, there are 188 lakh JLGs, with 54 lakh JLGs being promoted during the FY 2021-22, as compared to 41 lakh in the previous financial year. Furthermore, during FY 2021-22, loans amounting to INR 112,772.75 crore were disbursed. Furthermore, NABARD reports that Microfinance operations in India are widely distributed across 595 districts in 28 States and 5 Union Territories. As of March 31, 2022, the combined microcredit portfolio of 225 lenders stands at a substantial INR 262,599 crores. The microfinance sector experienced a remarkable 21% growth in FY23, reaching Rs 3,51,521 crore compared to Rs 2,89,845 crore in the previous year. A quarterly report by Sa-Dhan, an association of impact finance institutions, including MFIs, revealed that all types of microfinance players witnessed significant growth throughout the year, except for banks (other than SFB), which only saw a meagre 3% growth in their portfolio. Among the various institutions, NBFCs recorded an impressive 49% growth, while NBFC MFIs followed closely with a growth of 37%. Not-for-profits and SFBs (Small Finance Banks) also displayed substantial growth rates of 25% and 19%, respectively. The total disbursement by all lenders during FY23 amounted to Rs 3,19,948 crore, a 26% increase compared to the previous year. NBFC-MFIs were the leading lenders, disbursing Rs 1,24,063 crore, closely trailed by banks at Rs 1,16,402 crore during FY 22-23. In terms of year-on-year disbursement growth, NBFCs recorded the highest rate at 59%, followed by NBFC-MFIs at 48%, SFBs at 18%, NFPs at 18%, and banks at 7%. The number of loan accounts in the microfinance industry increased to 1,363 lakhs in FY 22-23 from 1,239 lakhs in FY 21-22, indicating a YoY growth of 10%. Specifically, NBFCs displayed the highest YoY growth in the number of loan accounts (23%), followed by NBFC-MFIs (15%), NFPs (6%), banks (6%), and SFBs (5%). According to Jiji

Mammen, ED & CEO of Sa-Dhan, the microfinance sector demonstrated significant performance during the last financial year. The industry's overall growth suggests that it has successfully emerged from the challenges posed by the Covid pandemic and is now on a path of growth. The introduction of new regulatory norms has created a level playing field, leading to the growth of NBFCs and NBFC MFIs portfolios.

8. National Strategy for Financial Inclusion

The Reserve Bank of India (RBI) unveiled the National Strategy for Financial Inclusion 2019-2024 on January 10, 2020, outlining its vision and objectives for financial inclusion policies in India. The strategy was collaboratively developed by the RBI, the central government, and financial sector regulators, namely the Securities and Exchange Board of India, Insurance Regulatory and Development Authority of India, and Pension Fund Regulatory and Development Authority of India. In this report, financial inclusion is defined as the process of ensuring access to financial services and timely and adequate credit for vulnerable and low-income groups at affordable costs. The impact of financial inclusion extends to multiple aspects, including boosting overall economic output, reducing poverty and income inequality, and promoting gender equality and women's empowerment. Drawing lessons from other countries, the RBI found that over 35 nations, including China, Brazil, and Indonesia, have implemented national financial inclusion strategies. Common themes across these countries include setting specific targets, enhancing payment infrastructure, establishing robust regulatory frameworks, focusing on last-mile delivery and financial literacy, leveraging innovation and technology, and regularly monitoring and evaluating progress. India has taken several steps to further financial inclusion, such as the Pradhan Mantri Jan Dhan Yojana (PMJDY), which has opened 34 crore accounts with deposits amounting to Rs 89,257 crore (as of January 2019). Other schemes like Pradhan Mantri Suraksha Bima Yojana and Atal Pension Yojana provide insurance and pension coverage to bank account holders. The RBI's bank-led model of financial inclusion, through differentiated banking licences and the Indian Post Payments Bank, has helped bridge the connectivity gap in remote areas. However, certain challenges persist, including inadequate infrastructure in rural and remote regions, poor telecommunication and internet connectivity, socio-cultural barriers, and limited players in the payment product space.

The RBI has identified six strategic objectives for the national strategy of financial inclusion: universal access to financial services, providing a basic bouquet of financial services, access to livelihood and skill development, financial literacy and education, customer protection and grievance redressal, and effective coordination. To achieve these objectives, specific milestones have been set, like ensuring banking access to every village or hamlet within a five km radius by March 2020, strengthening digital financial services to move towards a cashless society by March 2022, and providing every adult access to a financial service provider through a mobile device by March 2024. For universal access to financial services, the RBI suggests improving access to insurance and pension services for those enrolled under PMJDY. It recommends developing specific financial literacy modules for different target groups and expanding centres for financial literacy to reach every block in the country by March 2024. The measurement of financial inclusion is proposed through three key indicators: measuring access, such as the number of bank branches or ATMs for a specified population, measuring usage, like the percentage of adults with savings accounts, insurance, or pension policies, and assessing the quality of services through grievance redressal mechanisms. The RBI also recommends conducting surveys to identify current impediments to financial inclusion and assess customer rights awareness and the attitude of service providers towards customers.

9. Challenges with Microfinance in India

While the microfinance sector and financial inclusion have made significant progress in India, there are still several challenges that need to be addressed. Some of the key challenges include:

- ❖ **Limited Access to Formal Financial Services:** A large portion of the Indian population, especially in rural areas and marginalised communities, still lacks access to formal financial services like banking, insurance, and credit. This hinders their ability to save, invest, and protect themselves against financial risks.
- ❖ **Low Financial Literacy:** Many people, particularly in rural areas, have limited knowledge and understanding of financial products and services. This lack of financial literacy can lead to poor financial decision-making and misuse of credit, which could further exacerbate their financial vulnerabilities.
- ❖ **Informal and Unregulated Lending Practices:** In the absence of formal financial institutions, people often resort to informal and unregulated lenders who charge exorbitant interest rates and impose harsh repayment terms. This can lead to a cycle of debt and financial insecurity for borrowers.
- ❖ **Inadequate Last-Mile Connectivity:** Rural and remote areas often face challenges in accessing banking services due to the lack of physical branches and poor telecommunication infrastructure. This makes it difficult for financial institutions to reach the last mile and serve those in need.
- ❖ **Gender Disparities:** Despite efforts to promote gender equality, women still face significant barriers in accessing financial services and resources. Gender norms and societal restrictions often limit women's financial autonomy and decision-making power.
- ❖ **Credit Risk and Over-Indebtedness:** Ensuring responsible lending practices is crucial to prevent borrowers from becoming over-indebted. In some cases, borrowers take multiple loans from different sources, leading to credit risk and repayment challenges.
- ❖ **Regulatory and Policy Framework:** Although regulations have evolved to foster financial inclusion, there might be areas that require further fine-tuning to strike a balance between consumer protection and enabling access to financial services.
- ❖ **Technology and Digital Divide:** While digital financial services have the potential to enhance inclusion, a significant portion of the population still lacks access to smartphones, internet connectivity, and digital literacy.
- ❖ **Adequate Funding for Microfinance Institutions:** Sustainable growth of microfinance institutions (MFIs) requires access to affordable and stable funding sources. Attracting investment and securing funds on favourable terms can be a challenge for some MFIs. Addressing these challenges requires a multi-faceted approach involving collaboration among policymakers, financial institutions, civil society organisations, and technology providers. Measures such as financial education programs, innovative digital solutions, supportive regulations, and targeted interventions for marginalised groups can help advance financial inclusion and mitigate the hurdles faced by the microfinance sector in India.

10. Conclusion

The inclusion of women in the financial system is crucial to enhance their ability to generate income and to address the diverse aspects of poverty, vulnerability, and disempowerment they face. Achieving financial inclusion for women is primarily accomplished through programs like the SHG Bank-Linkage programme, MGNREGS, Micro credit, and Direct Benefit Transfer. Implementing community-based microfinance initiatives can elevate the status of women and should be pursued with a comprehensive approach, aiming to empower women and enhance their social and economic security through increased capacities and empowerment.

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