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Microfinancing: Feebling or thriving? A critical review

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Abstract
India, a developing country, rising its Gross domestic product, its Human Development Index, its financial capital and exports almost every year but one thing that is still sheer worrisome in this country is 'INEQUALITY'. About 1% richest of this country are keeping and controlling a revelatory portion of nation's wealth, meanwhile there is a significant population who is suffering from severe poverty. They are starving from nutritional food, good healthcare, better education, secured houses and employment opportunities. These people were relying on informal sources for small and big credits for a long time and getting exploited from big money lenders. This urban, rural division has always been a concern for our government and regulatory authorities. For narrowing down this division, Microfinancing has played a great role. Microfinance has emerged as a key strategy for poverty alleviation in India, particularly in rural areas, by providing financial services to underserved population. Poverty is defined by lack of income and inaccessible credit. It is necessary to make the financial product accessible to the underserved people for alleviation of poverty. Since independence, our government is trying to make it possible through Self-help groups, by development of Regional Rural Banks, by allowing NBFC-MFI and by initiating many more microfinancing programs like JAN-DHAN YOJNA, MUDRA YOJNA, KISAN CREDIT CARDS, JEEWAN JYOTI YOJNA etc. These initiatives have provided a significant change in financial exclusion. Microfinance has empowered millions, especially women and MSME's, by facilitating access to credit, savings, and insurance but there are certain challenges which are dragging down the effectiveness of these microfinancing initiatives. This sector faces several issues, including high interest rates, over-indebtedness, and limited sustainability of microfinance institutions (MFIs). This critical review examines the effectiveness, challenges, and limitations of microfinance initiatives in India. The review highlights the role of government policies, self-help groups, and the involvement of commercial banks in shaping the landscape of microfinance in India. Additionally, it scrutinizes the socio-economic impact of microfinance on beneficiaries, questioning whether it has led to substantial improvements in income generation and long-term financial independence. The review also addresses the ethical concerns regarding the commercialization of microfinance and the potential for exploitation of the poorest. Ultimately, the paper calls for a more integrated approach, with a focus on financial literacy, regulatory oversight, and innovative models to ensure the inclusivity and sustainability of microfinance in India.

Keywords: Microcredit, financial literacy, micro financial institutions, self-help groups, financial inclusion, indebtedness

Introduction

"Where the real economy leads, finance follows" By Joan Robinson

Microfinancing earlier refers to the practice of providing small loans or financial services to individuals or businesses, typically in low-income or developing regions, who do not have access to traditional banking services. These small loans, often referred to as microloans, are designed to help people start or expand small businesses, improve their living standards, or meet other basic needs. But now the meaning of microfinancing has expanded. It means providing access to all financial product like savings, credits and insurance to all the unserved or underserved population. The goal of microfinancing is to promote financial inclusion, reduce poverty, and encourage entrepreneurship, especially among marginalized groups such as women, rural residents, and the unemployed. Microfinance includes microloan/microcredit, micro savings and micro insurance.

Definition of Microfinance loan by RBI: A microfinance loan is defined as a collateral-free loan given to a household having annual household income up to ₹3,00,000. For this purpose, the household shall mean an individual family unit, i.e., husband, wife and their unmarried children."

Microfinance carries the potential of socio-economic transformation, particularly in low-income and underserved communities. By providing financial services such as credit, savings, insurance, and payment systems to individuals who are traditionally excluded from formal financial institutions, microfinance empowers individuals to break free from the cycle of poverty. This empowerment takes various forms, from fostering entrepreneurship and livelihood generation to promoting women’s economic autonomy and enabling access to critical services like education and healthcare.

History of Microfinancing: Microfinance, as described in the passage, was born out of the vision and pioneering work of Muhammad Yunus, a Bangladeshi economist. In the 1970s, while teaching at Chittagong University, Yunus began exploring ways to assist disadvantaged communities, particularly those living in poverty. His surveys of the Jobra village near his university revealed that traditional banking services were inaccessible to the poor. Banks were unwilling to lend to people who lacked assets or a credit history, and the only available alternative, local moneylenders, charged exorbitant interest rates.

Yunus was driven by a belief that the poor were just as capable of managing loans responsibly as anyone else, given the right opportunity. He realized that these communities had a strong sense of financial responsibility but lacked the resources to improve their circumstances. This insight led him to establish Grameen Bank in 1983, which became the first institution dedicated to providing microloans to the impoverished, particularly women.

The Grameen Bank followed Solidarity Group lending Approach and mostly focused on women for microloans.

History of microfinancing in India: In India, the concept of Microfinancing was started by SEWA (The Self-Employed Women Association) in Gujrat. SEWA was registered as workers group of independently employed ladies' laborers in 1972. This group set up their bank known as 'SEWA BANK' in which 4000 patrons contributed rupees 10 each for the financial capital of bank. And after this setup, this bank is enrolled as a co-employable bank and has been offering financial aid to helpless women. SEWA group became a motivation and multiple self-help groups were emerged. In 1988-89 NABARD embraced a study of 43 NGOs spread more than 11 states in India to consider the working of SHGs. Following this study The Reserve Bank of India (RBI) allowed banks to lend directly to Self Help Groups (SHGs) as part of the SHG-Bank Linkage Programme (SBLP) in 1992. The National Bank for Agriculture and Rural Development (NABARD) launched the SBLP as a pilot project in 1992-93. The SBLP was a partnership between banks, SHGs, and NGOs.

Following that, Regional Rural Banks were established in the year 1975 with a purpose of providing financial aid to the poorest of poor in rural areas. The first Regional Rural Bank (RRB) in India was Prathama Grameen Bank, which was established on October 2, 1975. The bank's headquarters were in Moradabad, Uttar Pradesh, and it was sponsored by Syndicate Bank. There is total 43 RRB's in India but government is planning to merge few and consolidating it to 28 as per the 'one state-one RRB' rule.

Government has also initiated several schemes throughout years.

1. **Microcredit Finance:** Under MCF Scheme, beneficiaries from the charmakar community receive the financial assistance of up to Rs 50000at an interest rate of 5% per annum.
2. **Prerna MCF scheme:** Dr B R Ambedkar development corporation launched this scheme in which SC/ST women self-help group will be financed up to rs2.5 lakhs to income generating activities.
3. **Mahila Samriddhi Yojana:** This scheme was launched as the part of National Backward Classes Finance and Development corporation. The government provides microfinance to the women entrepreneurs either directly or through self-help groups
4. **Aajeevika Micro-finance yojana:** Under this scheme government provide financial assistance upto90% of project cost of rupees 1.40 lakhs for small income generating activities at interest rate 11%.
5. **Ashray Adhaar Scheme:** This scheme was launched by GOA state for schedule tribes. It provides financial aid to schedule tribes for repairs, development and maintenance of their houses.
6. **Nirman Shramik Auzaar Toolkit Sahayata Yojana:** This scheme was launched by Jharkhand government to provide financial assistance to registered construction workers for purchasing of tools and equipment.
7. **Pradhan Mantri Mudra Yojana:** This is a flagship scheme launched by government in which financial assistance is provided to the non-corporate, Nonfarm sectors income generating activities up to rupees 10 lacs.
8. **Senior citizen Saving Scheme:** It is a retirement benefit Program in which an individual above the age of 60 can deposit the amount (minimum: Rs 1000 and maximum: Rs 1500000) for 5 years at the interest rate of 7.40% per year.
9. **Pradhan Mantri Jan Dhan Yojna:** PMJDY was launched in 2014 for enhancing the financial inclusion. Under this scheme Accounts can be opened in any bank branch with zero balance.

And just like this government, RBI and regulatory authorities are continuously trying to make the financial products and services accessible to the poorest of poor population of this country. The value of FI index was 60.1 for 2023 vis a vis 56.4 in 2022. CRISIL INCLUSIX stood at 58.0 for 2016 vis a vis 40.1 in 2011.NABARD ALL INDIA FINANCIAL INCLUSION SURVEY 2017 reported that among agriculture household owning more than 0.4 ha land, 32% reported to be having Kisan Credit Card. Among total 23% reported that any of its members were associated with any micro finance group or to a self-help group.

NABARD Report 2023-24 on micro financing

1. If we look at the region wise saving linked SHGs, NORTHERN REGION has the lowest percentage of 12.1%, meanwhile eastern region has the highest saving linked SHGs percentage which is 30%.
2. Credit distribution to SHGs has risen all across the country in 2023-24 by a growth rate of 68% in north eastern region, 54% in northern and central region.

3. Eastern region showing the maximum SHGs with 23,61377 SHGs, followed by southern region with 20,78,922 SHGs.

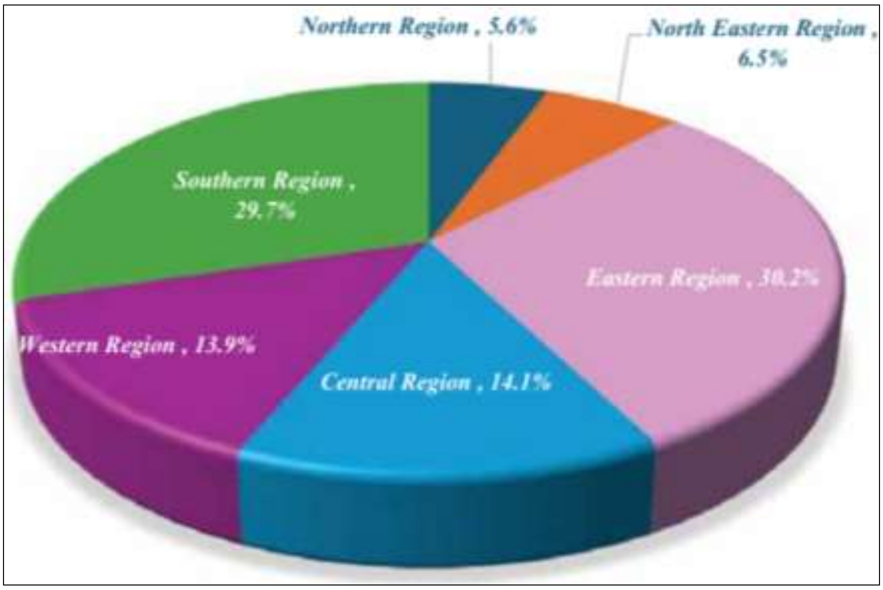

Fig 1: Region wise sharew (%) in no. of savings linked SHFs

Table 1: Region wise status of bank loans distributed to SHGs during 2021-22 to 2023-24

Region	2021-22		2022-23		2023-24	
	No. of SHGs	Total Loan distributed (₹. Lakh)	No. of SHGs	Total Loan distributed (₹. Lakh)	No. of SHGs	Total Loan distributed (₹. Lakh)
Northern region	79,532	1,17,102	1,02,931	2,06,437	1,38,391	3,18,183
North Eastern region	94,871	1,84,636	1,23,602	3,13,764	1,77,015	5,26,355
Eastern region	13,01,505	25,68,978	16,34,604	33,38,333	23,61,373	51,47,356
Central region	1,84,322	2,16,983	2,78,359	4,63,673	3,97,413	7,74,839
Western region	2,39,086	3,81,363	2,73,253	6,75,144	3,29,034	10,04,150
Southern region	14,98,951	65,03,860	18,82,772	95,22,672	20,78,922	1,31,57,704
Total	33,98,267	99,72,923	42,95,521	1,45,20,023	54,82,152	2,09,28,587

Table 2: Region wise SHGs having loans outstanding (as on 31 March 2024) (₹lakh)

Sr. No.	Regions	Loan outstanding with SHGs as on 31 March 2024 (₹ in lakh)		
		No. of SHGs	Amount outstanding	Average loan O/s per SHG
1	Northern Region	2,11,746	3,23,059.64	1.53
2	North Eastern Region	3,38,996	6,58,448.45	1.94
3	Eastern Region	27,55,982	58,10,341.05	2.11
4	Central Region	6,75,625	9,09,735.85	1.35
5	Western Region	5,13,040	10,38,343.92	2.02
6	Southern Region	32,46,395	1,72,26,443.7	5.31
	Total	77,41,784	2,59,66,372.61	3.35

Research Objective

- To evaluate the evolution of microfinancing by analyzing the historical review of microfinancing.
- To assess the effectiveness of microfinancing in providing access of financial products like savings, credits and insurance.
- To identify the challenges in microfinancing practice by reviewing the hurdles faced by customers and MicroFinancial Institutions.
- To analyze the sustainability of microfinance Institutions by evaluating the financial and operational sustainability.

Research Methodology: This study is based on both descriptive and analytical research methods. Data is collected from different secondary sources like articles and reports issued by RBI, NABARD and SIDBI, financial inclusion index issued by RBI, different government surveys and multiple literatures published on the topic of microfinancing. Tabular and diagrammatic analysis are used for interpreting the results and discussions.

Literature Review

- **Microfinancing And Its Impact on Improving National Economy, Atique Seikh, 2022:** In this study author examined the effects of microfinancing on the economic growth of a country. He collected primary data through a survey of 51 managers of microfinance institution and analyzed it on SPSS for a better understanding. This study shows an affirmative relationship between microfinancing and the growth of the country, shows that lending can help poor people to start their own business which leads to increase in employment and income generation. Author also focused on the challenges like indebtedness and lack of awareness which are creating the hindrances in economic development.

- **Microfinance and Women Empowerment in India, B K Sunitha:** This study talks about the effect of accessibility of financial product on women of economically backward section of the society. It surveys the economic transformation of developing countries like Bangladesh and India. In India there has been a vast development in self-help groups of women in past two decades which witnesses a strong economic sustainability. Urban poor and rural poor both are flourishing after getting financial aid for banking institutions.
- **A Review of Microfinancing Role in Entrepreneurial Growth in African Nations, Titilola Falaiye:** This study inquiries into different areas of microfinancing and examine the effect on entrepreneurship, poverty alleviation and economic development. Authors collected the empirical evidences from diverse African countries. By analyzing the case studies and empirical evidences, study concludes that the financial limitations are constrained for lack of entrepreneurial growth. Microfinancing serves as a catalyst for SMEs growth and sustainable development. It also points out the pitfalls and challenges in sustainability of Microfinancing Institutions which can be eradicated by incorporating a comprehensive approach.
- **Risk in Commercial Microfinancing-A social perspective from India, Debidutta Pattnaik:** This study raises the concern of mass commercialization of Microfinancing and how indebtedness is a growing risk in microfinance. Data collected from NSSO reveals that 22% of the urban households and 31% of rural households are indebted. People are using these debts either for consumption or on limited income sources which is aggravating the issue. This study concludes that farmer's suicide from indebtedness can be avoided if these institutions can shift their focus from being commercial to proponents of socio-economic transformation.
- **Andhra Pradesh Microfinance Crisis and Its repercussions on Microfinancing Activities in India, Prabhjot Kaur, Soma Dey:** This paper brings out the discussion regarding Andhra Pradesh microfinance crisis, 2010 which endangered the existence and sustainability of operation of microfinance institution in India. Andhra Pradesh enacted Andhra Pradesh Microfinance Institution (Regulation of Money Lending Act) in December 2012which halt the operation of many MFI's. In 2012 RBI intervened to prevent the collapse of the microlending industry. Authors concluded by stating that passing of reprieved Microfinance Bill if passed can bring optimistic change in the sector.
- **Microfinance in India: Issues, Challenges and Policy Options, Rajaram Dasgupta and Dinker Rao:** This paper highlights the benefit of linkage between formal and informal system of financial operations in India. It analyzes different model of Microfinancing and compares the different approaches like Individualistic and cooperation approach and self-help group BGG models and Cooperatives. It states that the microcredit domain is in dismal situation and this situation is because of the two constraints 1) Attitudinal 2) Institutional. Only appropriate policies, awareness and right SHGs models can remove these constraints.
- **The Impact of Pradhan Mantri Mudra Yojana on the socioeconomic development of women in India, Puspendra Kumar and Divya Nandra jog:** This study talks about Mudra Yojna launched by Indian Government for the upliftment of women and development of small and medium sector enterprise. Authors collected primary data from almost 300 women respondents through telephonic interviews. After the graphical and tabulation analysis, it indicates a positive role of mudra loans in improving the well-being of women in our society. Mudra loan has given a financial independence to these women by giving them an opportunity to put the money in income generating source.
- **Microfinance: A Critical literature survey, Thorston Beck:** This paper provides a critical survey of microfinance literature of past one decade. It suggests the moderate but not transformative effects of microcredit. It states that micro saving interventions are more promising but microinsurance needs more polishing. On the most basic level, high costs and risk are at the core of limited supply of financial services to the low end of the market. This study states that the lack of financial literacy, behavioral and intrahousehold constraints are the biggest barriers on the demand side. It also states that the higher profitability and positive growth of MFI in India is also a cause of increasing indebtedness in India.

Result and Discussion

The microfinance sector has experienced substantial growth over the past few decades, aimed at providing financial services to underserved populations, particularly those in poverty. After doing a careful tabular and diagrammatic analysis of RBI, NABARD and SIDBI report and some literature review we agree that the microfinancing is growing at increasing rate in India. Number of SHG's are way higher than it was in beginning of 2000 (especially in eastern and southern region of India)

There are some major positive impacts of microfinancing that we are seeing:

- **Poverty Alleviation and Entrepreneurial Growth**: Several studies have explored the effectiveness of microfinance in alleviating poverty. On one hand, microfinance institutions (MFIs) have been credited with improving access to financial resources, especially for women and rural populations. It is often argued that microloans provide individuals with the means to start small businesses, leading to increased income generation and improved livelihoods. For instance, studies by Armendáriz & Morduch (2010) [14] suggest that microfinance can lead to empowerment, particularly for women, by increasing their economic independence and social status.
- **Social and Gender Impact:** One of the most celebrated aspects of microfinance is its potential to promote gender equality. Studies have shown that women are more likely to benefit from microloans compared to men, especially in regions where women traditionally have limited access to financial resources. For example, the Grameen Bank has been lauded for its

success in empowering women through credit programs. Women borrowers often report improvements in self-esteem, household decision-making, and access to resources.

- **Way to financial Inclusion:** Government initiatives like Jan Dhan Yojna, kisan credit card, Mudra debit card, Bank linked SHGs are helping to make the financial product accessible to unserved and underserved population and make a way from financial Exclusion to Inclusion.

Along with these benefits, there are some serious challenges in the domain of microfinancing that we need to discuss:

- **Commercialization of Microfinance:** The commercialization of microfinance has been a contentious issue within the sector. Initially, microfinance institutions were established with a social mission, but many have since transitioned into more commercially-oriented organizations, sometimes resulting in a shift away from poverty alleviation as the primary goal. Critics like Yunus (2007) argue that commercialization undermines the core ethos of microfinance by prioritizing profits over social impact.
- **Rebranding of informal moneylenders as microfinancing institutions:** The whole process of availing credit is corruption ridden. Starting from the first step itself banking officials harasses individual promising them easy money in the form of loans. Once the customers are lured, they use illegal tactics to get the loan repaid. The recent incident where a youth in Andhra Pradesh committed suicide because he was being harassed over a ₹2000 loan using morphed pictures of his wife highlights the plight of borrowers in India.
- **Increasing the level of Indebtedness in India:** Indebtedness means staying in the loop of heavy debt. As per the report of All India Debt and Investment survey, average debt per house is rupees 59,748 but in urban households it is rupees 1,20,336. People are suiciding because of heavy debt trap. Recently we came across a suicide case in which a young man identified as S Narendra dies by suicide due to heavy debt burden. And just like that we have seen so many cases of people taking their life because of indebtedness.
- **Sustainability of micro financial institutions is in danger:** Microfinance institutions face significant challenges regarding their financial sustainability. Many MFIs operate in a challenging environment where borrowers often lack credit history, and loan repayment can be unpredictable. The costs of administering small loans, especially in remote or rural areas, can also be high, leading to concerns about the financial viability of such programs. We can take the example of Mudra loans: only 42% of Mudra loans are disbursed till yet and why is that? The increasing burden of NPAs, which rose by 32% in the first half of 2024. Multiple microfinancing lending is based on group lending model where defaults can be inevitable in the case of drought, bad crop or failure of business.
- **Increased interest rates and non- access of funds:** The marginal operating cost for microfinancing agencies is quite high as most of their loans forwarded is collateral free. This compels them to lend at a higher interest rate to break even or earn profits. But most of their potential borrowers can't afford funds at such high interest rates. RBI has uplifted the interest rate ceiling on collateral free loans and it has propelled average interest rate to about 24% by joint liability groups. It is closer to the interest or sometimes even lesser than the interest rates offered by banks. These high interest rates have made credit inaccessible to the neediest once again.

In case of PM SVAnidhi Scheme, several problems like uneven distribution, Narrow coverage, Lack of statistics or groundwork were noticed. As per the study conducted by the Probe, 75% of beneficiaries are from seven states and union territories and the least beneficiaries are from SC/ST communities.

- **Geographical challenges and lack of awareness:** India's infrastructure has highly improved since independence but there are still corners in Rajasthan, Haryana, Bihar and Jharkhand where infrastructure and transportation are a big problem. Street vendors and farmers are not properly educated to read and write. They are not even aware about the existence of these microfinancing schemes. A study conducted in various cities by Sydney University shows that 52% of vendors were not even aware about the flagship microfinancing scheme PM-SVANidhi.
- **Lack of CIBIL records and letter of recommendation:** Most of the MFIs don't provide loans without CIBIL record and Letter of recommendation which make the loan inaccessible for the small vendors and small farmers from backward areas.

Conclusion

The critical review of microfinancing suggests that while it has made significant strides in promoting financial inclusion, its ability to reduce poverty on a large scale is still debatable. If we look at demand side, people are not accessing the loans due to high interest rates, illiteracy, inconsideration of MFIs, lack of CIBIL score etc. On the other hand, If we analyze supply side, MFIs and Government is also hurting as microcredits increasing NPAs every day. They can't reduce interest rates as their transaction and operating cost are really high. Going forward, a more nuanced approach to microfinance is necessary, one that accounts for the diversity of experiences across different regions and populations. The future of microfinance may lie in blending traditional approaches with new technologies (Such as mobile banking and fintech), which can improve access to financial services while reducing the cost and administrative burden of traditional microloans. Policymakers require to come up with some hybrid model that can bring profitability to MFIs and financial inclusion in country

The effectiveness of microfinance in poverty alleviation hinges on improving regulatory frameworks, ensuring ethical lending practices, and addressing the limitations of the commercialization trend. Moving beyond simplistic narratives of success or failure, microfinance must be integrated into a broader, multi-faceted development strategy that also includes education, healthcare, and infrastructure to create lasting change.

In conclusion, while microfinance has undeniably provided opportunities for economic participation, its impact on poverty reduction is mixed and requires careful consideration of both its social and financial outcomes. Further research and policy development are needed to refine its model and ensure that it fulfills its promise of supporting the world's most vulnerable populations.

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