

Microfinance in India-A Catalyst of Financial Inclusion and Economic Growth: With Special Reference to Bihar

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Abstract

Microfinance has emerged as a vigorous tool for alleviation of poverty and unemployment. It is also the catalyst of financial inclusion, specifically in developing regions. This paper highlights on the concept of microfinance, Microfinancing Institutions (MFIs), their outreach, and their socio-economic impact on the local population and in fostering sustainable development. Almost a hundred million rural households have seen an improvement in their standard of living due to microfinance during its three-decade journey. Regulations and government initiatives have aided in the sector's expansion, providing direction for its growth. In India, microfinance institutions have been instrumental in providing small loans, particularly to underprivileged groups who lack collateral. They are making a significant impact on the nation's effort to achieve financial inclusion. The microfinance industry is highly heterogeneous, with a wide range of organisations operating under distinct legislative frameworks. It includes banks, SFBs, NBFCs, non-profit MFIs, and NBFC-MFIs. This study is an attempt to ascertain the efficacy of microfinance in India, with a specific focus on the structural fabric of Bihar, a state known for its socio-economic challenges.

Keywords: Microfinance, Financial Inclusion, Self Help Groups, Poverty, Microcredit, MFIs, NABARD, Bihar

Introduction

Microfinance refers to the amalgamation of two terms i.e., micro and finance which represents the mechanism of providing finance and basic financial services at a micro level. It implies to the provision of catering financial services to the smallest unit or fragment of the population like individuals of low income group or to those who have no access to conventional banking services. Microfinance assimilates the concept of microcredit, micro savings, micro insurance, and remittances. Bihar presents a distinctive case for understanding the efficacy of microfinance due to destitution and vulnerability prevalent in the form of issues of poverty and unemployment, low literacy rates, and socio-economic challenges. This paper aims to explore how microfinance initiatives have contributed to economic empowerment and social development.

The primary cause of the development in the credit gap was the inability of the SHGs with outstanding loans to keep up with the growth in savings linkage of the group. This highlights how important it is to

expand and extend the reach of microfinance, especially to areas and populations with more potential for growth.

Literature Review

The concept of microfinance gained global recognition with the success of the Grameen Bank in Bangladesh, founded by Nobel Laureate Muhammad Yunus. In India, microfinance has evolved through various models, including self-help groups (SHGs), microfinance institutions (MFIs), and cooperative societies. Studies have shown mixed results regarding the impact of microfinance on poverty alleviation. While some researchers highlight significant improvements in income, health, and education, others point to issues like over-indebtedness and high interest rates.

According to Sinha (2005), microfinance has evolved as a significant tool to combat poverty by facilitating financial inclusion, aiming to provide credit and other financial services to marginalized populations. Studies like that of Basu and Srivastava (2005) highlight the role of self-help groups (SHGs) and MFIs in enhancing the socio-economic status of women, leading to improved household decision-making and increased income levels.

Much discussion has always surrounded the impact of microfinance on alleviating poverty in India. Swain and Varghese (2009), contend that microfinance has resulted in a decrease in poverty and an enhancement of living standards. According to their findings, households' economic stability has increased because of investing in income-generating ventures made possible by access to microcredit.

Nonetheless, alternative research, as conducted by Banerjee et al. (2015), offers a more complex perspective, spilling bewilderment on the long-term viability and feasibility of these activities. Their contention is that although microfinance can provide immediate advantages, its capacity to substantially modify poverty rates in the long run is restricted in the absence of supplementary measures like healthcare and education.

The MFIs that target rural borrowers are limited in their outreach owing to sustainability considerations, it is more difficult to extend financial inclusion in rural areas than in urban ones (Lopez & Winkler, 2018).

By decreasing the non-performing assets (NPAs) of the SHGs and allocating funds toward micro-level planning and self-sustenance training, microfinance when exercised in true spirit can surely contribute to robust growth (Samineni & Ramesh, 2023)

Objectives of the Study

- To study the concept and need of microfinance as a means to provide financial services to the unbanked masses.
- To identify the role of microfinance in facilitating financial inclusion and economic growth.
- To assess the barriers and hurdles encountered in implementing and availing microfinance services respectively by microfinance institutions and beneficiaries.
 - To ascertain the role of microfinance with specific reference to Bihar.

Research Methodology:

The data form various books, journals, newspapers, reports and web articles are the basis of this study.

Discussion:**Microfinance in India**

In India, microfinance has become a crucial tool for alleviating poverty and bolstering financial inclusion, especially in rural areas. Microfinance institutions (MFIs) provide financial services to low-income individuals and small businesses that lack access to traditional banking services. Microfinance in India has grown rapidly, with the Reserve Bank of India (RBI) playing a pivotal role in regulating the sector. The Microfinance Institutions Network (MFIN) and Sa-Dhan are two prominent industry associations that promote responsible microfinance practices.

MFIN works closely with regulators and other key stakeholders in creating an ambience for universal financial inclusion through microfinance. Its primary objective is to strive to attain robust development of the microfinance sector.

Whereas, Sa Dhan has about 222 members who are engrossed working in 33 States and Union Territories of India. It is working in more than 600 districts of the country. It incorporates both for profit and not-for-profit micro finance institutions, SHG promoting institutions, banks, rating agencies, capacity building institutions and many more. The members have vast and diverse legal forms and operating models as they reach out to approximately 44 million clients with loan outstanding of more than INR 1,27,801 crores. It is also recognized as a national support organization by National Rural Livelihood Mission. The ultimate objective of Sa Dhan is the development, promotion and support of ecosystems to impact financing institutions which enables inclusive growth, equity, gender equality and sustainable development in the society.

Microfinance Institutions (MFIs) that do business in India are subject to regulation by the Reserve Bank of India (RBI). A regulatory framework for non-banking financial companies, or NBFC-MFIs, was released by the RBI in a master circular dated July 1, 2014, on NBFC-MFIs. For NBFC-MFIs, the RBI had released comprehensive regulations that address a number of topics, including complaint handling, pricing of credit, qualifying assets, eligibility for registration, transparency, preventing borrower over-indebtedness, and protection of client data. Due to this, the industry now has the essential legitimacy and boost. MFIs often follow the Industry Code of Conduct, stay compliant with regulations, and handle client protection matters. All parties involved benefit greatly from these characteristics when it comes to confidence

Even though India is growing at a very impressive pace in every sector, a significant proportion of the population is still uninsured and uninvolved by the established banking system. As the majority of these individuals do not have a bank account, making it even more difficult for them to obtain a bank loan to infuse finance in their project or investment in avenues to generate source of livelihood.

To grant a loan, banks require certain documents and papers, such as a reliable source of income, creditworthiness, likewise many more documents and credentials. Individuals or groups of marginalised section of the society generally does not possess any of these and therefore, they are the ones who will never be able to obtain credit to meet their monetary requirements. Banks are under a compulsion to verify the documents such as evidence of identity, proof of address, PAN, Aadhar card, and proof of applicant's ongoing work. These documents are difficult to be maintained by the vulnerable sections of the society. Thus, there was a dire need for an alternative system as microfinance to fulfil the petty requirements of such individuals and groups who are in dearth of such documents due to their misery, illiteracy and poverty.

Service Providers of Microfinance

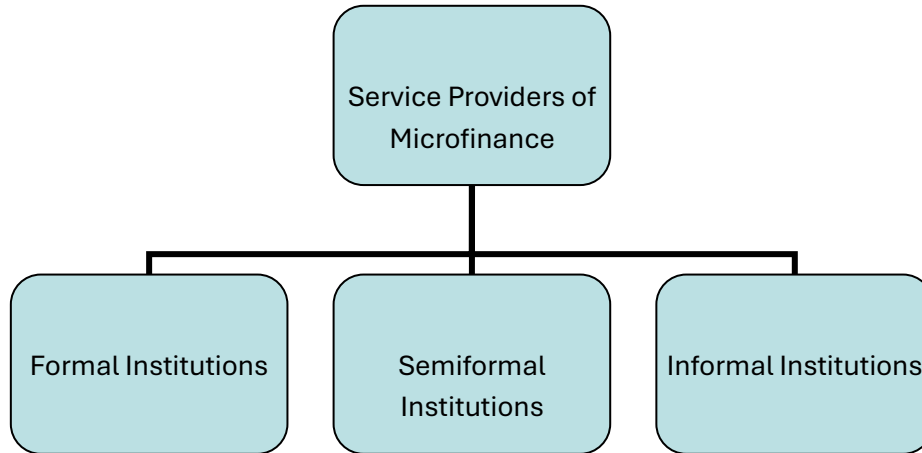


Figure 1: Microfinance Service Providers

The service providers of microfinance can be categorised into formal, semiformal and informal institutions comprising the following:

Formal Institutions are comprised of Rural Banks, Co-operative Banks, Grameen Model Banks.

Semiformal Institutions are Non-Government Institutions **Whereas, Informal Institutions** are composed of Money lenders, Shopkeepers, etc.

With a vast array of businesses functioning under various legal frameworks, the microfinance sector is incredibly diverse. It consists of non-profit MFIs, banks, Small Finance Banks (SFBs), Non-banking Financial Company (NBFCs), and NBFC-MFIs.

SHG Bank Linkage Programme

A Self-Help Group (SHG) is generally defined as a collection of at least twenty persons who are financially and socially similar and who assemble freely with the aim of saving and obtaining credit, without the need for collateral for loans or credit use in the end. SHGs should have the ability to handle loans and savings, follow credit rules and regulations, adapt defined rules and bylaws, hold regular meetings, record meeting minutes, and function fairly.

Regulatory Difficulties

Despite the growth of microfinance, the sector faces challenges such as regulatory constraints, operational risks, and socio-cultural barriers.

Regulatory Framework Complications : There are several agencies and authorities that oversee the microfinance industry in India, creating a highly complex, complicated and occasionally inconsistent regulatory framework. It can be difficult for microfinance institutions (MFIs), particularly the smaller ones, to navigate this framework.

Imprecise Guidelines: Frequently, there are imprecise guidelines pertaining to customers.

Awareness Level: A considerable disparity in financial literacy exists among customers which contributes to unwise financial choices and challenges in efficiently handling loans. Loan recovery procedures and interest rate caps, might causes MFIs to operate inconsistently.

Aspect of Sustainability and Scalability: Due to their poor payback rates and high operating costs, many MFIs have financial sustainability issues. Their financial stability may encounter difficulties beca-

use of restricted access to capital, technological limitations, and managerial constraints.

Concerns related to the Customers: Borrowing from several sources can certainly push the customers at a danger point of becoming overly indebted. This issue is worsened by the absence of a centralized system for credit information.

Insufficient evaluation of impact: A lot of MFIs do not possess reliable systems to exactly ascertain as how their services create impact on the society.

Incorporation of Technology: Remote and rural areas are left far behind in the adoption of digital technologies in microfinance for its effective channelisation.

Economic Growth and Financial Inclusion in Bihar

Bihar, is historically a very significant state of India, which is populous and has long been under the grip of various impoverishment and vulnerability. The state's economy is largely agrarian, with limited industrialization and infrastructure. Social factors, including caste-based discrimination and gender inequality, further exacerbate economic disparities. However, in recent years, microfinance has emerged as a powerful tool to drive economic growth and financial inclusion in the region. It has certainly created a ripple as an impact on the local economy as well as the challenges and opportunities it presents.

Role of Microfinance in Bihar

Studies have indicated that access to financial services has enhanced the status of women in their respective home as well as in the community. Despite, women currently make up the majority of the impoverished population, they now indeed tend to be more dedicated and determined. In addition, women now own property and housing, participate in society affairs more confidently. Their contributions are appreciable as they play powerful roles in their networks, as a desired outcome of microfinance endeavours.

Thus, in Bihar, where a large fragment of the population resides in rural areas and relies on agriculture, microfinance has played a crucial role especially for uplifting the status and conditions of women.

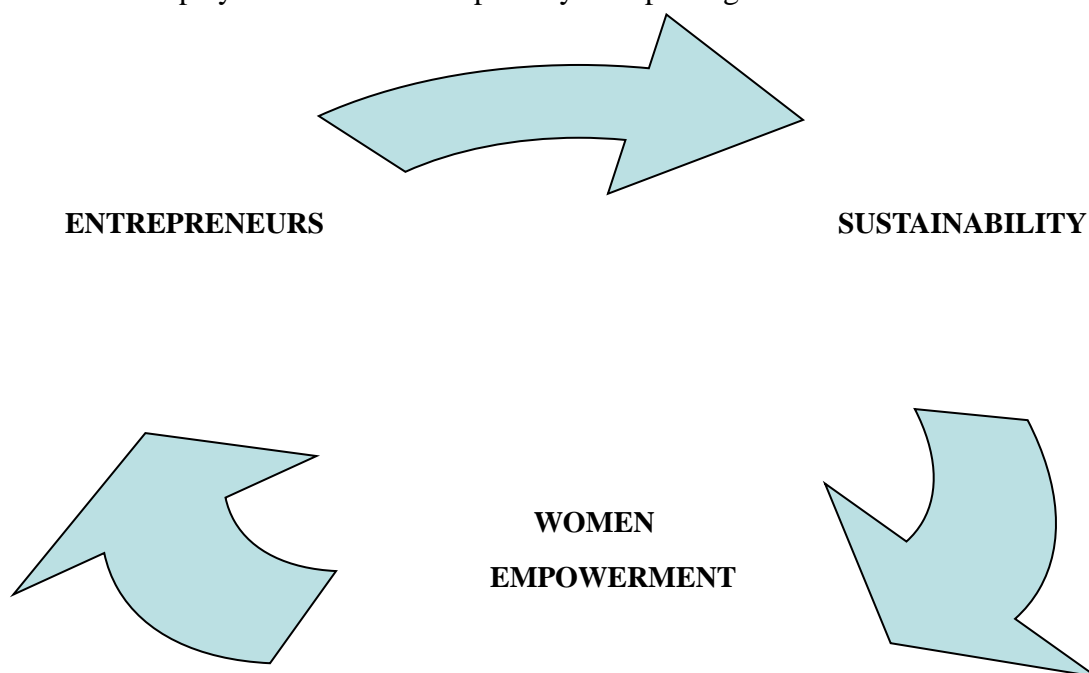


Figure 2: Role of Microfinance

- **There could be possibility of able entrepreneurs:** MFIs provide credit to individuals and small groups to support them in starting the business or for their business expansion, leading to job creation and economic diversification.
- **Source of Livelihood & Sustenance:** Microfinance facilitates the families to invest in income-generating activities, which enhances their living standards and helps in combating poverty.
- **Actualisation of Women Empowerment:** A substantial chunk of the customers of microfinance in Bihar are women, who use these funds to actualise financial independence and support their families to meet their respective pecuniary requirements.

Microfinance Providers:

There are various MFIs which initiated to operate in Bihar. They definitely played a key role in contributing to the economic development of the state in unique ways. Professionals with a stable source of income or those operating in the organized sector who are salaried or self-employed are typically eligible for loans from the established lending institutions. The people who work in professions like fishing, crafts, building, vending, small business ownership, etc. avail credit /loan from microfinance. These people typically reside in distant villages or urban slums, and they may be labourers in the unorganized economy. They qualify to avail microfinancing services of microcredit, savings, insurance, money transfers at micro level.

In the state, since there are a substantial number of borrowers in the microfinance sector. The state also has a low literacy rate, the impoverished segment of the population relies primarily on informal means of funding. Microfinance organizations are attempting to close the gap between the supply and demand of funds with the emergence of informal pathways. In certain states, including Bihar, the government concentrates on creating business models with the goal of offering IT resources and solutions to the rural populace, in addition to income-generating endeavours.

In the state, institutional microfinance has served in addition to Self-Help Groups and linking initiatives. NIDAN was the first microfinance organization established in the state of Bihar. It adhered to the cooperative and SHG microfinance methods. NIDAN was founded as an unofficial organization to give money to young people to prepare them for financial independence through appropriate training. It also imparts developmental facilities for effective utilization of funds raised by the borrowers.

Role of State Government

When it comes to the microfinancing in Bihar, the State government has an essential role to play. The state's financial inclusion and the growth of the microfinance industry had been aided by several initiatives and programs, including the National Rural Employment Generation Act (NREGA), Bihar Rural Livelihood Promotion Society (Jeevika), Mukhyamantri Nari Shakti Yojana (MMNSY), and Swarnajayanti Gram Swarozgar Yojana (SGSY). The banks were tasked with creating one account for every household in Bihar to attain financial inclusion. The Primary Agricultural Cooperative Society (PACS) was revived at the Panchayat level, establishing the platform for democratically addressing the developmental issues and challenges.

Obstacles to the Development of Microfinance in Bihar

The Bihar economy had been shambled with numerous obstacles, although the government has been constantly working to eliminate such hindrances to successfully channelise the result-oriented services

of microfinance in the state.

1. The infrastructural fragility has an adverse impact on outreach and group support overall as well as on the efficiency plus cost of any work or project.
2. The conventional observation is that the outlook of financial institutions towards Self-Help groups is not very encouraging.
3. The accessibility of funds by the startups has not been credible, but with implementation of new Policies of the central government, the startups are finding it a little easier to secure fund.
4. The funding operations are hindered by the regional imbalance caused by the non-proportionate distribution of Self-Help Groups.
5. Challenges including caste-related disputes and domestic abuse hinder the development of microfinance in Bihar.

Another major disadvantage of MFIs and non-governmental organizations is their lack of experience in managing the rural population.

Avenues and Prospects for Growth and Development

There are various options that can be investigated to get over these obstacles and realize the full potential of microfinance:

1. **Technology Integration:** By utilizing digital technologies, microfinance operations can become more efficient to swiftly penetrate to remote areas.
2. **Coordination and Induction with Government Programs:** Microfinance programs can have a greater impact if they are coordinated with government initiatives like the Pradhan Mantri Jan Dhan Yojana (PMJDY).
3. **Financial Products Innovation:** It is possible to reduce risks and promote economic stability by creating innovative financial products that are suited to the unique requirements of the people living in Bihar, such as weather-indexed insurance for farmers.

Microfinance enhances Human Existence: Recipients of microfinance advances have the ability to rise above the clouds of acute poverty and unemployment since they possess the knowledge along with resources necessary to improvise their own lives. Credits are granted through microfinance in Bihar to competitive and profitable projects with minimal default rates.

Challenges: Microfinance in Bihar

Despite its success, the microfinance sector in Bihar faces several challenges:

- Economic instability and natural disasters, such as floods, can lead to high default rates on microloans.
- Clients sometimes borrow from multiple sources, leading to over-indebtedness and financial stress.
- The expansion of the microfinance industry has also been impacted by the loans provided to Bihar's unemployed rural people under the subsidized Swarozgar Yojana.

Brighter Side

Bihar has overtaken Tamil Nadu to become the state with the highest micro lending borrowings in India as of March 2023, according to a report released by credit information company CRIF High Mark, which highlighted Bihar's impressive growth in the gross lending portfolio. As per the report of March 2024, it has secured second rank in the same, very close to Tamil Nadu.

As of March 2023, microfinancing borrowings amounted to INR 48,900 crore amounting to 49.5% of the overall portfolio. This impressive shift in rankings reflects Bihar's rising prominence in the microfinance sector.

Impact of Microfinance on the Local Economy of Bihar

Several facets of the regional economy in Bihar are impacted by microfinance:

- 1. Agricultural output:** By using microloans to purchase improved seeds, fertilizers, and irrigation systems, a large number of small farmers have raised agricultural output.
- 2. Small-Scale Industries:** By promoting the expansion of small-scale businesses like food processing, weaving, and handicrafts, microfinance has given rural people access to alternate sources of income.
- 3. Financial Literacy:** MFIs frequently offer financial literacy programs in addition to their loan activities, which assist clients in improving their money management and making wise financial decisions.

Conclusion

This study evaluated that microfinance institutions have significantly expanded their outreach in Bihar, particularly in rural areas. However, there is considerable variation in penetration across different districts, with some areas remaining underserved.

It is concluded that microfinance has shown to be a game-changer, promoting social empowerment, financial inclusion, and economic prosperity. Microfinance may continue to be a key player in creating a more affluent and inclusive future for Bihar by tackling the obstacles and grasping new opportunities. The benefits of microfinance are anticipated to grow as stakeholders collaborate to fortify this ecosystem, helping even more people and communities throughout the state.

Acknowledging the great potential offered by e-commerce and digital marketing platforms to strengthen demand-side dynamics, open direct B2C and B2B channels, improve price discovery and SHG/JLG (Joint Liability Groups) incomes, and improve forward linkages, NABARD launched a program in 2022–2023 to train and assist SHGs, JLGs, Point of Sales (Pos), and microentrepreneurs in selling their goods online with the assistance of industry players.

The largest microfinance program in the world is identified to be the self-help group bank linkage program, as per the NABARD (2022–2023) status of microfinance in India report. Through more than 134 lac self-help organizations, it addresses 16.2 crore families with deposits of over INR 58,893 crore annual loan offtake of more than INR 1,45,200 crore, and loan outstanding of over INR 1,88,079 crore.

On a national level, according to CRIF High Mark Report for March 2024, the following are the highlights:

Microfinance sector witnessed quarterly growth of 8.5% in the book, and Y-o-Y growth of 26.8% as of March 2024. Live customer base grew by 6.1% Q-o-Q and by 17.6% Y-o-Y for the same period. The Retail exposure of MFI borrowers is dominated by Home Loans, Agri KCC and Gold Loans by value. Volume Gold Loans, personal loans and Consumer Durable loans have the highest share and highest Y-o-Y growth in POS for Property Loans (41.4%) and Personal Loans (38.3%) have been witnessed in the aforesaid period.

Microfinance has the fool proof potential to be a transformative tool for socio-economic development in the country. However, to actualise the maximum limit of its potential, it is essential to address the challenges and obstacles faced by microfinance providers and borrowers. By implementing policy

interventions, microfinance can become a more effective and inclusive mechanism for poverty alleviation and financial inclusion at the national level as well as the state level.

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