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Role of Microfinance in small Industries in the Economic Development of India

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Abstract
Microfinance plays a significant role in India's growth. It strives to assist economically excluded communities in achieving better asset creation and income security at the family and community level. The country's microfinance sector showed signs of recovery during the fourth quarter of the financial year 2021-22, following the pandemic, with over 13% portfolio growth among lenders from the previous quarter and around 5% year-on-year (YoY) growth, indicating field activities returning to near normalcy. According to a research, the gross loan portfolio (GLP) of the entire microfinance industry increased by 11.9% from Rs 2,31,787 crore on March 31, 2020 to Rs 2,59,377 crore on March 31, 2021. The disbursements of NBFC-MFIs increased to Rs 30,216 crore in Q4 FY22 from Rs 27,364 crore in Q4 FY21. The purpose of the study is the role of the Microfinance Industry in India, which finances micro, small, and medium-sized enterprises (MSME) in India.
Keywords: RBI, Micro Finance, Banks, NBFCs, Micro, Small and Medium Enterprises (MSME)

1.Introduction

India is a developing nation whose rural economy serves as its foundation. In developing nations such as India, microfinance institutions play a crucial role in alleviating poverty and improving economic conditions. In devolving nations, micro, small, and medium-sized firms have been the primary source of employment and income for a significant portion of the population.

Microfinance operations rose to prominence in the early 1990s, and the Reserve Bank of India (RBI) identified it as a new paradigm with enormous development potential and was very supportive of its expansion. The informality and adaptability of microfinance have been of enormous assistance to the nationwide microfinance movement including regular people. Over the past decade, the microfinance industry has undergone tremendous transformations. As a result of mergers of NBFCs and MFIs, as of September 2020, the percentage of NBFC-MFIs in the microfinance market in terms of gross loan portfolio was slightly more than 30%. As the sector grew, however, some deficiencies and shortcomings became evident, culminating in the Andhra Pradesh (AP) microfinance crisis of 2010. This disaster was ascribed to the irrational exuberance of certain MFIs, which, in their zeal to expand their businesses, had disregarded conventional wisdom and good practices, such as due diligence in lending and ethical recovery practices. However, Microfinance Institutions satisfy the financial needs of MSMEs. MFIs

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become the sole source of growth funding for numerous small businesses. Microloans between Rs.20,000 and Rs.30,000 are the most popular in India. However, the category of loans between Rs. 30,000 and Rs. 40,000 increased by 56% between Q3 FY18 and Q3 FY19. As of March 31, 2019, the microfinance industry has experienced an increase of 44 percent year-over-year. (According to CRIF's High Mark Report) Microloans between Rs.20,000 and Rs.30,000 are the most popular in India. However, the category of loans between Rs. 30,000 and Rs. 40,000 increased by 56% between Q3 FY18 and Q3 FY19, As of March 31, 2019, the microfinance industry has experienced an increase of 44 percent year-over-year. (According to CRIF High Mark Report) MFIN is a trade organisation made up of 58 NBFC-MFIs and 39 associates, including banks, small finance banks (SFBs), and NBFCs. According to the research, as of March 31, 2021, the microfinance industry served 5.93 billion unique borrowers through 10.83 billion loan accounts. It was stated that 13 banks control the main share of the micro-credit portfolio with outstanding loans totaling Rs 1,13,271 crore, or 43.67 percent of the whole micro-credit universe. The studies revealed that non-banking financial companies-microfinance institutions (NBFC-MFIs) are the second largest source of microcredit with an outstanding loan balance of Rs 80,549 crore, representing 31.05% of the total industry portfolio. The outstanding loan balance for small finance banks (SFBs) is Rs 41,170 crore, with a total share of 15.87%.

Microcredit is distributed via a number of institutional channels, including (i) scheduled commercial banks (SCBs) (including small finance banks (SFBs) and regional rural banks (RRBs)) lending both directly and through business correspondents (BCs) and self-help groups (SHGs), (ii) cooperative banks, (iii) non-banking financial companies (NBFCs), and (iv) microfinance institutions (MFIs) registered as NBFCs as well as Microfinance institutions are financial institutions that provide small-scale credit and savings services, mostly to the underprivileged in rural, semi-urban, and metropolitan areas. These financial services are intended to assist people in engaging in economic activities, reducing their susceptibility to income shocks, smoothing their consumption, boosting their savings, and fostering their self-empowerment. There are numerous microfinance companies in India that play crucial roles in the country's growth.

The microfinance industry in India is fragmented, with over 3000 microfinance institutions (MGIs), non-governmental organisations (NGOs), and NGO-MFIs. It is estimated that the top 10 microfinance organisations in India account for around 74% of all outstanding loans. The outstanding loan balance in the Indian microfinance business is between 160 and 175 billion dollars. As of March 31, 2009, around seventeen Indian microfinance institutions had more than one million outstanding loans.

2. About Microfinance Institution in India

Microfinance, also known as microcredit, primarily consists of extremely modest loans of approximately Rs.100,000 granted to an individual or group of individuals known as self-help organisations (SHGs). Borrowers typically come from the weakest segments of society. The Reserve Bank of India (RBI), the nation's central bank, has urged banks to adopt the SHG model for lending to over 30 million small and micro units in order to facilitate their access to capital. The Indian microfinance industry include of NGOs, trusts, and societies that operate on a not-for-profit basis, as well as larger for-profit organisations like as Spandana, SKS, Basix, Share Microfin in Andhra Pradesh, Cashpor in Uttar Pradesh, and Grameen Koota in Karnataka. The microfinance business is expected to serve approximately 10% of credit-seeking poor households. MFIs arose in the late 1990s to raise social and commercial capital for lending to the poor. There are currently over a thousand MFIs in India, the majority of which serve the rural poor. Several MFIs have also recognised the possibilities of urban poor financing. Urban MFIs include Uplift, an alliance of urban MFIs, Society for the Promotion of Area Resource Centres (SPARC), Swadhar FinAccess, Bandhan, and Ujivan. In the absence of adequate collateral, it is difficult for banks to lend to MFIs.

To broaden their capital base, numerous MFIs such as Biswa, Grameen Kuta in Bangalore, and Bandhan in West Bengal have changed into non-banking finance companies (NBFCs).

3. Review of Literature

Sheokand (2000) investigated the evolution of Indian savings and the emergence of microfinance as a means of assisting a broad clientele. Fisher and Sriram (2002) discovered that in India, savings at the local level have been thriving for an extended period of time. Yunus (2007) also stated that the entire rural credit ecosystem may be transformed by merely channelling the money flow at the grassroots level into a proper framework. In his article, Sarkar (2008) examined the new microfinance model in Bangladesh and the need for institutional reforms in India's microfinance development plan. According to him, the development of a variety of fresh, appealing savings and loan options for its consumers is urgently required. Microfinance has been an essential instrument for empowering women and alleviating poverty. It has provided financial services and credit to India's underprivileged and unbanked population, thereby promoting financial inclusion. Sarmah and Das (2012) analysed the socioeconomic development of the impoverished in Assam's Lakhimpur District through microfinance. According to the findings of the study, economic empowerment has enabled rural poor to enhance their income and improve their level of living. Ritesh Dwivedi and Akshay Kabra (2019). Underneath the surface, there exists a vast opportunity for MFIs to acquire more and more consumers. In India, the needs of poor families are severe, and access to credit is limited. Today, every state has a substantial number of microfinance service providers, and it is necessary to support them by fostering an enabling environment and enhancing physical facilities. Some segments of rural population are unaware of these services, so MFIs must organise several awareness campaigns to inform them about the services and goods available and how they would benefit them. Micro- and small-sized businesses were the backbone of the traditional village system, and some village businesses are still operating across the nation; these businesses require financing, and MFIs must seize this opportunity with both hands. To further improve their standard of living, leaks must be identified and effectively sealed. Health issues are a major source of financial loss for a family, thus education and acceptance of insurance programmes constitute the heart of intervention. Education and shelter are also important factors to consider for improved lifestyles.

4.Role of Microfinance

Microfinance is the provision of financial services to low-income clientele, small organisations, and self-employed individuals who lack access to regular banking and related services. Typically, microfinance initiatives have targeted women. By offering access to financial services only via women, making women responsible for loan repayment, managing savings accounts for women, and providing insurance coverage through women, microfinance programmes convey a powerful message to both households and communities. Microfinance's function in economic development is to satisfy the needs of economically marginalized populations. Briefly, the objective of microfinance is to fund the livelihood, health care, housing upgrades, small business creation, and other requirements of underserved groups, particularly poor and near-poverty level individuals in the United States and internationally. Microfinance institutions are the key international organisations in each nation that provide direct microcredit loans to villagers, microentrepreneurs, impoverished women and poor families. An international MFI is comparable to a small bank in that it faces the same obstacles and capital requirements as any other small business, with the extra obligation of helping economically disadvantaged populations. Numerous MFIs are creditworthy, well-managed, and have a track record of success; many are also operationally self-sufficient.

5. Customer Protection Concerns in the Microfinance Sector

a) Over-indebtedness and Multiple Lending

NBFC-MFIs are subject to the full regulatory framework, whereas other small lenders such as cooperatives and local lenders, which account for approximately 70% of the microfinance portfolio, are not subject to equivalent regulatory constraints. Consequently, small borrowers are increasingly able to obtain many loans from multiple lenders, which contributes to their over-indebtedness and can potentially show itself in coercive recovery techniques. This undermines the primary purpose of protecting small borrowers contained in the NBFC-MFI regulations, which prohibit multiple NBFC-MFIs from lending to the same borrower. In addition, there is a regulatory cap on the maximum amount an NBFC-MFI can lend to a microfinance borrower. With a reduction in the proportion of NBFC-MFIs to the total volume of microfinance, the client becomes the victim of excessive debt.

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b) Pricing of Microfinance Loans

The regulatory interest rate cap applies exclusively to NBFC-MFIs. Over the years, regulatory directives and clarifications have resulted in a complicated system of rules governing the cost of funds. The specified ceiling on lending rates for NBFC-MFIs has had the unintended effect of stifling competition, resulting in pricing parity among the majority of lenders. There is worry that the current standards, which prescribe a maximum interest rate for only NBFC-MFIs, essentially serve as a regulatory standard for all lenders. Despite significantly reduced cost of funding, banks' lending rates also hover around this ceiling. Even among NBFC-MFIs, expanding operations resulting in higher economies of scale have not led to a discernible drop in lending rates. Thus, it is the borrowers who are deprived of the advantages of increased competition and economies of scale. Therefore, there is an unequal playing field, which compromises customer protection.

c) Need for Review of the Current Regulatory Framework

The purpose of the existing regulatory framework for NBFC-MFIs is to make credit accessible to low-income people in a transparent way while protecting borrowers from any predatory lending practices used by lenders. However, again, this framework only applies to 30% of the microfinance loan portfolio. Emerging microfinance sector dynamics and customer protection issues necessitate a revision of the legislation to ensure that all microfinance regulated entities (REs) pursue client safety within a calibrated and standardised framework.

The primary objective of the regulatory body is to address concerns regarding the over-indebtedness of microfinance borrowers and to enable the market mechanism to bring down interest rates in the microfinance sector, while empowering borrowers to make informed decisions by enhancing existing mechanisms on loan pricing transparency. While introducing lender-neutral and activity-based regulations in the microfinance sector, the Reserve Bank is also aware that certain prudential norms specific to NBFC-MFIs should not be harmonised with other regulatory entities (REs) in order to address the idiosyncratic risks arising from NBFC-MFIs' concentrated exposure to unsecured microfinance loans. In addition, the proposed regulations shall be implemented in a non-disruptive manner, and all REs shall be given ample opportunity to comply with the recommendations following their implementation.

Before proceeding with the proposed changes to the regulatory framework, it would be prudent to examine the important existing norms governing the NBFC-MFIs' activities.

d) Regulatory Approach towards Microfinance

In an effort to integrate client-centric ideas into the operations of NBFC-MFIs, the regulations have attempted to ensure that the product design and delivery are to the clients' benefit. As the majority of NBFC-MFI consumers are socially as well as financially weak, a 'fair practices code' with an appropriate grievance redressal system has been established for NBFC-MFIs to ensure customer protection and transparency.

As noted previously, in the aftermath of the AP microfinance crisis in 2010, the Reserve Bank of India (RBI) established a committee under the leadership of Shri Y H Malegam to examine issues and concerns in the MFI industry. The regulatory approach towards microfinance has been heavily influenced by the Malegam Committee's suggestions. The following are the primary recommendations of the Malegam Committee:

a. Establishment of a distinct type of NBFCs operating in the microfinance sector, to be known as NBFC-MFIs

b. the criteria for identifying microfinance loans as "qualified assets."

b. Prudential standards for capital adequacy and provisioning

d. Prescriptions concerning credit pricing in terms of a margin cap and interest rate cap on individual loans

e. Transparency in interest rates and other loan terms and circumstances f. Measures to combat multiple lending, over-borrowing, and forceful recovery techniques
g. Establishment of a suitable grievance redress system

6. Challenges Faced by MFIs in India

Although microfinance institutions have been profitable in India, there have been regulations and populist politics that have proved to be unfavourable to them. The small size of these institutions imply that they will be affected by small adverse developments resulting in fragile finances.

Banks usually have multiple products and an assured deposit structure. On the other hand, micro lending institutions are highly dependent on the market for funding. This means that at the smallest of events affecting business, MFIs could find it difficult to procure financing.

Additionally, banks today have a presence in the microlending space and they are also partnering with MFIs through strategic stakes. MFIs are also finding it difficult to grow independently without any support from anchor investors.

Several microfinance institutions have converted into small finance banks. This implies that they can lend at higher interest rates. Moreover, they will have access to deposits that are low-cost. Banks are now some of the largest providers of micro-finance as per MFIN reports. MFI-turned banks are still the major providers of micro finance.

Since financial inclusion is on the rise, MFIs have many more years of opportunity remaining. The key to their survival is the constant backing from investors.

The biggest risk looming over the microfinance industry today is the tendency to overborrow on the part of loan seekers. As per CRIF High Mark data, there was a hike in the average microfinance loan size within the last 2 years. Several borrowers have also attempted borrowing from multiple lenders.

7. Conclusion

In order to support small enterprises, MFIs are working to make their services better, by the way of understanding unique needs of MSME. They are tailoring their services and working toward making the process much easier so that, MSME can easily avail their services. With the help of management MFIs can create client concentric approach, with hiring knowledgeable and dedicated staff. RBI is also making amendments in the norms for the microfinance industry so that they will boost the funding.

The gross loan portfolio (GLP) of the entire microfinance industry increased by 11.9% from Rs 2,31,787 crore on March 31, 2020 to Rs 2,59,377 crore on March 31, 2021. The disbursements of NBFC-MFIs increased to Rs 30,216 crore in Q4 FY22 from Rs 27,364 crore in Q4 FY21. This shows that MFI is growing year by year and providing financial support to small and medium size business. In developing nations like India and other nations, the concept of micro finance loans and micro finance institutions has been embraced. Now, Micro finance lending has become the lifeline for the MSME. Such Institutes help many deprived sections of the society, so that they can become able to integrate with the main stream. However, microfinance plays the most significant role in alleviating poverty in society. Numerous banks in India have begun lending money to microfinance institutions. It works towards the empowerment of women, which is a major step towards the country's growth.

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