

## Role of Micro Finance in uplifting Indian Economy: An Analysis

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### **Abstract**

Microfinance institutions (MFIs) act as indispensable financial intermediaries, providing small loans and services to individuals excluded from mainstream banking due to socio-economic constraints. Their significance lies in empowering marginalized communities, promoting financial inclusion, and fostering opportunities for income generation and entrepreneurship. Notably, microfinance contributes significantly to poverty alleviation and gender equality, particularly in empowering women, who often constitute a substantial portion of its beneficiaries.

However, the effectiveness of microfinance in India faces multifaceted challenges. This paper addresses hurdles such as exorbitant interest rates, insufficient infrastructure, and the urgent need for effective regulation to prevent the exploitation of vulnerable borrowers

Overall, this paper will find out the indispensable role of microfinance in India's economic development while acknowledging the challenges hindering its full potential. Unravelling these dynamics provides policymakers, practitioners, and stakeholders with a comprehensive understanding of microfinance in the Indian context, crucial for formulating informed strategies that foster sustained growth and ensure its continued positive impact on economic development. The insights gleaned from this study are vital for shaping the trajectory of microfinance in India.

### **Introduction**

In the vast expanse of India's economic landscape, amidst the bustling cities and tranquil rural villages, a silent revolution has been underway – one fueled by the principles of financial inclusion, empowerment, and social justice. At the heart of this revolution lies the phenomenon of microfinance, a dynamic force that has reshaped the contours of economic development and uplifted millions from the shackles of poverty. This research endeavors to delve deep into the intricate tapestry of microfinance in India, unravelling its roles, challenges, and transformative impact on the socio-economic fabric of the nation.

Microfinance, as a concept, epitomizes the spirit of inclusivity, offering a lifeline to those traditionally excluded from the formal financial sector. Through a myriad of financial services – ranging from small loans and savings accounts to insurance products and remittance facilities – microfinance institutions (MFIs) have endeavored to bridge the gap between the haves and have-nots, providing marginalized communities with the tools and resources needed to chart their own path towards prosperity.

The evolution of microfinance in India has been nothing short of remarkable. From its humble beginnings as a grassroots movement championed by visionaries like Muhammad Yunus, microfinance has grown into a multi-

billion-dollar industry, encompassing a diverse array of players – from non-governmental organizations (NGOs) and self-help groups (SHGs) to commercial banks and fintech startups. Alongside its expansion, microfinance has also witnessed a paradigm shift in its objectives, transitioning from a purely philanthropic endeavor to a sustainable business model driven by social impact and financial inclusion.

However, the journey of microfinance in India has not been without its fair share of challenges. Issues such as over-indebtedness, high interest rates, and regulatory constraints have plagued the sector, raising questions about its long-term viability and ethical implications. Moreover, the COVID-19 pandemic has exacerbated existing vulnerabilities, posing unprecedented challenges to the resilience and sustainability of microfinance institutions and their clients.

Amidst these challenges, the potential of microfinance to drive meaningful change remains undeniable. As India strives towards realizing its vision of inclusive growth and sustainable development, understanding the nuances of microfinance – its successes, failures, and evolving dynamics – becomes imperative. Through rigorous research and analysis, this paper aims to shed light on the intricacies of microfinance in India, offering insights into its transformative power as a catalyst for economic empowerment, social inclusion, and human dignity.

### **Literature review**

Pioneering works by Muhammad Yunus and others established the theoretical foundations of microfinance, highlighting its potential to uplift impoverished communities.

Early studies emphasized the importance of providing small-scale financial services to the unbanked and underserved, laying the groundwork for subsequent research.

Research in the Indian context has examined the evolution of microfinance institutions (MFIs) and their strategies for outreach and impact.

Studies, such as those by Banerjee and Duflo, have provided empirical evidence of microfinance's efficacy in poverty alleviation and women's empowerment within India's diverse socio-economic landscape.

Scholars have critically analyzed the challenges facing the microfinance sector in India, including concerns over over-indebtedness, high interest rates, and coercive lending practices.

Research has proposed innovative solutions to address the limitations of traditional microfinance models, such as leveraging digital finance platforms, implementing peer-to-peer lending mechanisms, and exploring impact investing opportunities.

Scholars advocate for continued research and reforms to ensure the sustainability and equitable impact of microfinance in India.

### **Microfinance in India – a brief story**

Microfinance in India has traversed a remarkable journey, evolving from humble beginnings to become a cornerstone of financial inclusion and poverty alleviation efforts. Initially introduced in the 1970s through self-help groups (SHGs) and non-governmental organizations (NGOs), microfinance gained traction as a tool for empowering the economically marginalized. However, it wasn't until the 1990s that microfinance witnessed a significant expansion with the establishment of formal Microfinance Institutions (MFIs) like SKS Microfinance and Bandhan Financial Services

During this period, the microfinance landscape in India experienced rapid growth, fueled by innovative approaches such as group lending, peer monitoring, and doorstep banking. The success stories of individuals lifting themselves out of poverty through microfinance loans captured global attention and spurred further investment and expansion.

However, the microfinance sector in India faced a severe setback in the early 2010s with the Andhra Pradesh microfinance crisis, characterized by over-indebtedness, coercive recovery practices, and borrower suicides. This crisis prompted a regulatory overhaul, leading to the passage of the Microfinance Institutions (Development and Regulation) Act, 2010 (MIDRA), aimed at bringing greater transparency and accountability to the sector.

Despite the challenges, microfinance in India has continued to evolve, with a growing emphasis on client protection, social performance management, and responsible lending practices. The emergence of digital technologies and mobile banking has further revolutionized the delivery of microfinance services, enabling greater outreach and efficiency.

Looking ahead, the future of microfinance in India holds both promises and challenges. The sector is poised to play a crucial role in advancing financial inclusion, promoting entrepreneurship, and fostering sustainable development. However, ensuring responsible and inclusive growth remains imperative, requiring concerted efforts from policymakers, regulators, and practitioners to address issues of over-indebtedness, client protection, and sustainability. The evolution of microfinance in India reflects a transformative journey marked by resilience, innovation, and adaptability. As the sector continues to evolve, it holds the potential to unlock opportunities and empower millions to build brighter futures for themselves and their communities.

### **Impact of Microfinance on Poverty Alleviation**

Microfinance has been widely touted as a powerful tool for poverty alleviation, offering financial services to individuals who are traditionally excluded from the formal banking sector. Proponents argue that access to microcredit enables poor households to invest in income-generating activities, smooth consumption, and build assets, thereby breaking the cycle of poverty.

Several studies have provided evidence of the positive impact of microfinance on poverty reduction. For instance, taking 12 data from NABARD, we find that the number of SHGs increased significantly from 637 in 1994 to 22.4 lakh by 2006. Juxtaposing the data provided by the All-India Debt and Investment Survey (AIDIS) in 2003 for Tamil Nadu, we get a fairly similar picture of the predominance of informal sources in general, moneylenders in particular. We find that of the total number of rural households in the State, 68 per cent reported having taken at least one loan from informal sources and of these, 53 per cent reported at least one loan from professional moneylenders.

Moreover, microfinance has been credited with empowering women, who often bear the brunt of poverty's effects. By providing women with access to financial services, microfinance enables them to generate income, make decisions about household finances, and invest in their children's education and health. The sampled women members belonging to various SHGs in the studied region relied heavily on other informal sources of finance notwithstanding the fact that they were associated with the SHGs for over five years and in the micro finance parlance, were considered as matured members. Critics argue that the benefits of microfinance may be overstated, with some studies questioning the sustainability of microenterprises created through microcredit and highlighting the risk of over-indebtedness among borrowers. While microfinance has demonstrated potential in lifting individuals and communities out of poverty, its effectiveness depends on various factors, including the design of microfinance programs, the socioeconomic context, and the support services provided to borrowers.

Table 1: Region-wise progress of saving linked SHGs with Banks (2016-17 – 2018-19)  
(Amt. Rs. Lakhs)

Regions	2016-17		2017-18		2018-19	
	No. Of SHGS	Savings Amt.	No. Of SHGS	Savings Amt.	No. Of SHGS	Savings Amt.
Northern Region	457199	49676.28	478883	49293.91	548624	62452.82
North Eastern Region	452887	22955.7	485591	32207.59	523469	40407.05
Eastern Region	1953076	336538.57	2130997	441803.18	2654358	601154.88
Central Region	848514	83898.12	902222	95385.11	1062759	133230
Western Region	1140601	138696.27	1097448	124694.93	1388615	205275.15
Southern Region	3724598	979657.7	3649296	1215826.8	3836418	1289928.25
<b>Total</b>	<b>8576875</b>	<b>1611422.64</b>	<b>8744437</b>	<b>1959211.52</b>	<b>10014243</b>	<b>2332448.15</b>

Source: NABARD

### Impact of microfinance institution

Microfinance Institutions (MFIs) in India play a pivotal role in extending financial services to the unbanked and underserved populations, thereby fostering economic inclusion and empowerment. By providing small loans, savings accounts, and other financial products tailored to the needs of low-income individuals, MFIs enable them to access capital for income-generating activities, smooth consumption, and build assets.

One of the key contributions of MFIs is their ability to reach marginalized communities, including rural populations and women, who are often excluded from the formal banking sector. Through innovative delivery mechanisms such as self-help groups (SHGs), village-level banking agents, and mobile banking platforms, MFIs bridge the gap between financial institutions and the grassroots, making financial services more accessible and affordable.

Moreover, MFIs in India have been instrumental in promoting entrepreneurship and fostering economic development at the grassroots level. By providing credit to small businesses and microenterprises, MFIs stimulate local economies, create employment opportunities, and empower individuals to break the cycle of poverty.

Additionally, MFIs play a crucial role in promoting financial literacy and capacity building among their clients, equipping them with the knowledge and skills to manage their finances effectively and make informed financial decisions.

Overall, MFIs in India serve as catalysts for inclusive growth and poverty reduction, empowering millions of individuals, and communities to realize their full economic potential and improve their quality of life. However, challenges such as over-indebtedness, sustainability, and regulatory constraints underscore the need for continuous innovation and collaboration to maximize the impact of microfinance interventions.

Table 2.1: Progress under SHG-Bank Linkage Programme (2020-21 to 2022-23)							
(Number in lakh/₹ in crore)							
Particulars		2020-21		2021-22		2022-23	
		No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount
SHG Savings with Banks as on 31st March	Total SHG Nos.	112.23 (9.57%)	37477.61 (43.31%)	118.93 (5.97%)	47240.48 (26.05%)	134.03 (12.7%)	58892.68 (24.67%)
	All women SHGs	97.25 (10.11%)	32686.08 (40.16%)	104.05 (6.99%)	42104.77 (28.81%)	112.92 (8.52%)	52455.48 (24.58%)
	% of Women	86.65	87.21	87.43	89.13	84.25	89.07
	Of which NRLM/ SGSY	64.78 (11.9%)	19353.7 (35.22%)	71.84 (10.89%)	27576.94 (42.49%)	82.01 (61.19%)	37424.80 (63.55%)
	% of NRLM/ SGSY groups to Total	57.72	51.64	60.40	58.38	61.19	63.55
	Of which NULM/ SJSRY	5.29 (12.79%)	1954.09 (28.26%)	5.81 (9.87%)	2600.19 (33.06%)	7.39 (27.11%)	3547.12 (36.42%)
	% of NULM/ SJSRY groups to Total	4.71	5.21	4.89	5.50	5.51	6.02
Loans Disbursed to SHGs during the year	Total No. of SHGs extended loans	28.87 (-8.23%)	58070.68 (-25.22%)	33.98 (17.71%)	99729.22 (71.74%)	42.96 (26.42%)	145200.23 (45.59%)
	All women SHGs	25.9 (-10.19%)	54423.13 (-25.75%)	31.5 (21.63%)	93817.21 (72.38%)	41.42 (31.49%)	139315.69 (48.50%)
	% of Women Groups	89.71	93.72	92.70	94.07	96.42	95.95
	Of which NRLM/ SGSY	15.84 (-22.69%)	29643.04 (-43.19%)	22.91 (44.64%)	63100.77 (112.87%)	34.87 (52.20%)	116479.07 (84.59%)
	% of NRLM/ SGSY groups to Total	54.87	51.05	67.42	63.27	81.18	80.22
	Of which NULM/ SJSRY	1.13 (-28.93%)	2112.04 (-37.99%)	1.84 (62.45%)	5816.1 (175.38%)	1.98 (8.03%)	8627.25 (48.33%)
	% of NULM/ SJSRY groups to Total	3.91	3.63	5.40	5.83	4.62	5.94
Loans Outstanding against SHGs as on 31st March	Total No. of SHGs linked	57.8 (1.81%)	103289.71 (-4.43%)	67.4 (16.61%)	151051.30 (46.24%)	69.57 (3.22%)	188078.80 (24.51%)
	No. of all Women SHGs linked	53.11 (3.89%)	96596.6 (-4.00%)	62.65 (17.96%)	142288.61 (47.30%)	65.15 (3.99%)	179468.42 (26.13%)
	% of Women SHGs	91.89	93.52	92.95	94.20	93.65	95.42
	Of which NRLM/SGSY	33.78 (-8.43%)	57336.62 (-15.33%)	44.54 (31.87%)	94231.52 (64.35%)	55.45 (24.48%)	150506.71 (59.72%)
	% of NRLM/ SGSY groups to Total	58.44	55.51	66.09	62.38	79.70	80.02
	Of which NULM/SJSRY	2.23 (-16.48%)	4056.45 (-25.8%)	3.27 (46.52%)	7608.57 (87.57%)	3.42 (4.59%)	11077.18 (45.59%)
	% of NULM/ SJSRY groups to Total	3.86	3.93	4.85	5.04	4.91	5.89

(Figures in parenthesis indicate the increase/decrease over previous year)

## Women empowerment through microfinance

Commencing a journey towards gender parity and economic autonomy, microfinance stands as a potent instrument for fostering women's empowerment in India. Through the provision of financial services tailored to their needs, microfinance institutions (MFIs) empower women to break barriers, seize opportunities, and assert control over their economic destinies.

At the heart of microfinance's impact lies its ability to facilitate economic independence and self-sufficiency among women. By accessing microloans, women embark on entrepreneurial ventures, augment household incomes, and wield greater influence in financial decision-making processes, catalyzing transformative change within their families and communities.

Furthermore, microfinance programs prioritize the inclusion of women, whether as primary borrowers or members of self-help groups (SHGs). These platforms not only offer women access to financial resources but also provide



avenues for collective action, skill enhancement, and peer support, bolstering their socio-economic standing and confidence. **According to RBI report, the sample of SHG members selected for the survey reveals the following points. First, the entire sample was of women SHG members. Secondly, about 56 per cent of the women interviewed reported a family income of less than Rs. 40,000 per annum making their monthly family income approximately Rs. 3,300. Thirdly, about 26 per cent of these women were housewives, but the rest 74 per cent were engaged in various occupations.**

In addition to economic empowerment, microfinance addresses systemic gender disparities in access to financial services and assets, challenging traditional norms and fostering a more equitable society. By promoting women's economic participation and agency, microfinance becomes a catalyst for broader societal progress and gender equality objectives.

In essence, microfinance serves as a beacon of hope, illuminating pathways for women to transcend societal barriers, embrace entrepreneurship, and chart their own course towards a future defined by prosperity and empowerment. Yet, to fully realize its potential, concerted efforts are required to address structural inequalities, amplify women's voices, and create an environment conducive to gender-inclusive development initiatives.

### **Microfinance Regulation and policy framework**

The regulation and policy framework surrounding microfinance in India is crucial for ensuring the sector's integrity, stability, and inclusivity. Since the microfinance crisis in Andhra Pradesh in the early 2010s, there has been a heightened focus on strengthening regulatory oversight to prevent similar occurrences and promote responsible lending practices.

The Microfinance Institutions (Development and Regulation) Act, 2010 (MIDRA) was a significant milestone in regulating the microfinance sector in India. MIDRA aimed to bring MFIs under the purview of a unified regulatory framework, thereby enhancing transparency, consumer protection, and systemic stability. The act established the Microfinance Development Council to oversee the implementation of microfinance policies and monitor the performance of MFIs.

Additionally, the Reserve Bank of India (RBI) plays a central role in regulating and supervising MFIs, particularly those categorized as non-banking financial companies (NBFCs). RBI's regulatory directives cover various aspects of microfinance operations, including prudential norms, capital adequacy requirements, and fair lending practices. Furthermore, RBI periodically reviews and updates its guidelines to address emerging risks and promote the sustainable growth of the microfinance sector.

Alongside regulatory measures, policymakers have also focused on fostering a conducive policy environment for microfinance institutions to thrive. Initiatives such as the National Rural Livelihoods Mission (NRLM) and the Pradhan Mantri Mudra Yojana (PMMY) have been instrumental in promoting financial inclusion and supporting the expansion of microfinance services to underserved areas and vulnerable populations.

Despite these efforts, challenges persist in ensuring effective regulation and supervision of the microfinance sector. Issues such as mission drift, over-indebtedness, and regulatory arbitrage require continuous monitoring and regulatory intervention to safeguard the interests of borrowers and maintain the sector's integrity. Going forward, policymakers must strike a balance between fostering innovation and ensuring prudent risk management to realize the full potential of microfinance in driving inclusive economic growth and poverty reduction in India.

### **Challenges faced by microfinance institutions.**

The microfinance sector in India faces a multitude of challenges that impede its ability to effectively serve its target population and achieve its poverty alleviation objectives. One significant challenge is the issue of over-indebtedness among borrowers, where individuals accumulate multiple loans from different microfinance institutions (MFIs) or informal lenders, leading to unsustainable debt burdens and financial distress.

Furthermore, the sustainability of MFIs themselves is often a concern, particularly for smaller or less established institutions. High operational costs, limited access to funding, and volatile market conditions can jeopardize the financial viability of MFIs, hindering their ability to expand outreach and maintain quality service delivery.

Another challenge lies in ensuring responsible lending practices and client protection. In the past, instances of coercive loan recovery practices and usurious interest rates have tarnished the reputation of the microfinance sector and eroded trust among borrowers. Balancing the need for financial inclusion with the imperative of consumer protection remains a delicate balancing act for regulators and practitioners alike.

Moreover, the regulatory environment governing microfinance operations in India can be complex and fragmented, posing compliance challenges for MFIs and inhibiting innovation and growth. Harmonizing regulations across different states and ensuring effective supervision and enforcement mechanisms are critical for promoting a conducive operating environment for microfinance institutions.

Lastly, external factors such as macroeconomic instability, political uncertainty, and natural disasters can also impact the microfinance sector, affecting borrower repayment capacity and institutional stability.

Addressing these challenges requires a multi-faceted approach involving collaboration between policymakers, regulators, MFIs, and other stakeholders. Emphasizing responsible lending practices, strengthening regulatory oversight, promoting financial literacy, and fostering greater transparency and client protection are essential steps towards building a more resilient and inclusive microfinance sector in India.

### **Microfinance Innovations and best practices**

Microfinance institutions (MFIs) continually innovate to enhance their outreach and impact, employing a variety of strategies and best practices tailored to the needs of their clients and the local context. One such innovation is the use of technology to expand access to financial services. Mobile banking, for example, allows MFIs to reach remote areas where traditional brick-and-mortar branches are not feasible. By leveraging mobile phones for loan disbursement, repayment, and account management, MFIs reduce transaction costs, improve convenience, and reach a wider client base.

Another innovative approach is the integration of financial education and capacity-building initiatives into microfinance programs. By providing training on financial literacy, entrepreneurship, and business management, MFIs empower clients to make informed financial decisions, manage their businesses effectively, and improve their overall financial well-being. This holistic approach not only enhances the impact of microfinance but also fosters sustainable livelihoods and resilience among clients.

Furthermore, some MFIs have adopted a client-centric approach, tailoring their products and services to meet the specific needs of different client segments. This may include offering flexible loan terms, savings products, or insurance options designed to address the unique challenges faced by clients in various sectors or demographic groups.

Overall, microfinance innovations and best practices demonstrate the sector's commitment to continuous improvement and adaptation to better serve the needs of low-income individuals and communities, ultimately contributing to poverty reduction and inclusive economic growth.

### **Conclusion**

In conclusion, the journey through the role and challenges of microfinance in India's economic development reveals a complex landscape of opportunities and obstacles. Microfinance has undoubtedly emerged as a powerful instrument for financial inclusion, poverty alleviation, and women's empowerment, reaching millions of unbanked and underserved individuals and communities across the country.

Through the provision of small loans, savings accounts, and other financial services, Microfinance Institutions (MFIs) have enabled low-income households to access capital, start businesses, and build assets, thereby fostering economic resilience and social empowerment. Moreover, microfinance has demonstrated its potential to stimulate local economies, create employment opportunities, and contribute to sustainable development at the grassroots level.

However, the journey of microfinance in India has not been without its challenges. The sector has grappled with issues such as over-indebtedness, coercive recovery practices, and regulatory constraints, as highlighted by the Andhra Pradesh microfinance crisis. These challenges underscore the importance of striking a delicate balance between financial inclusion and responsible lending, ensuring that microfinance interventions are sustainable, ethical, and inclusive.

Moving forward, addressing the challenges facing the microfinance sector requires a multi-faceted approach that involves collaboration between policymakers, regulators, practitioners, and other stakeholders. Efforts should be directed towards enhancing consumer protection mechanisms, strengthening regulatory oversight, and promoting transparency and accountability within the sector.

Ultimately, the evolution of microfinance in India reflects a dynamic interplay between innovation and adaptation, resilience and transformation. As we chart the course ahead, it is imperative to harness the potential of microfinance as a catalyst for inclusive growth, poverty reduction, and sustainable development, while remaining vigilant against the pitfalls that may hinder its progress. By doing so, we can pave the way for a more inclusive and prosperous future for all.

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