Economic Growth through Microfinance- Is High Cost Finance Sustainable for The Borrowers in India?

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Abstract

A high cost financial tool named as "Micro-finance" is playing a key role in today's economy to contribute the economic growth of our country, especially in rural India. While Micro-finance proofs being helpful to the social –wellbeing to fulfil Sustainable Development Goals like income generation, financial inclusion, poverty alleviation and women empowerment, on the other side it's questioning in achieving other goal like sustainable economic growth and reducing inequalities. This article critically evaluates whether NBFC-MFIs genuinely support India's economic growth or prioritize their profit with charging high cost on /micro-loans.

Keywords: Micro-finance, High cost, Social-wellbeing, Sustainable Development, Financial inclusion.

Introduction

Microfinance in India serves as a pivotal tool for financial inclusion, aimed at providing access to financial services for low-income households and marginalized communities. It focuses on extending small loans (microcredit), savings options, insurance, and other financial products to individuals who lack access to conventional banking systems.

Microfinance and it's need in India

Microfinance refers to financial services tailored for low-income individuals or groups, designed to help them build sustainable livelihoods. It includes:

- **Microcredit**: Small loans for income-generating activities.
- **Savings**: Promoting a habit of saving among underserved populations.
- **Insurance**: Providing basic health, life, and asset insurance.
- **Remittance Services**: Facilitating secure and affordable money transfers.

India's vast population includes a significant segment that is financially excluded, particularly in rural and semi-urban areas. The traditional banking system often fails to meet the needs of these populations due to:

- Lack of collateral.
- Small loan sizes those are unviable for formal banks.
- High transaction costs for servicing remote areas.
- Limited financial literacy among the poor.

Microfinance bridges this gap by offering customized financial solutions with simple procedures, flexible repayment terms, and community-based approaches.

Objectives of Microfinance in India

1. **Promote Financial Inclusion**: Bring underserved populations into the financial system.

2. **Empower Women**: Many microfinance programs are women-centric, enabling their economic and social empowerment.

3. **Support Livelihoods**: Provide credit for income-generating activities like farming, small businesses, and handicrafts.

4. **Alleviate Poverty**: Enable households to manage risks, smooth consumption, and invest in education, health, and productive activities.

Key Stakeholders in Indian Microfinance

1. **Microfinance Institutions (MFIs)**: Organizations like SKS Microfinance, Spandana, and Bandhan play a vital role in providing microcredit.

2. **Banks and Financial Institutions**: Regional Rural Banks (RRBs), Cooperative Banks, and commercial banks support microfinance directly or through partnerships.

3. **Non-Governmental Organizations (NGOs)**: Act as facilitators or intermediaries in delivering microfinance services.

4. **Government and Regulators**:

i) **NABARD**: Promotes the SHG-Bank Linkage Program.
ii) **Reserve Bank of India (RBI)**: Regulates NBFC-MFIs and ensures customer protection.

Role of Microfinance in India

1. **Economic Development**: Facilitates entrepreneurship, especially in rural and semi-urban areas.

2. **Social Empowerment**: Encourages women's participation in economic activities and decision-making.

3. **Poverty Reduction**: Helps families overcome financial challenges and improve their standard of living.

Current Trends in Indian Microfinance

- **Technology Integration**: Use of mobile banking, digital payments, and fintech platforms for faster and secure services.

- **Diversified Services**: Expansion into micro-insurance, education loans, and healthcare financing.

- **Policy Support**: Government schemes like Pradhan Mantri Mudra Yojana (PMMY) and financial literacy initiatives strengthen the sector.

In summary, microfinance in India plays a transformative role in bridging the financial divide, fostering economic growth, and enhancing social equity. It continues to evolve with innovations in technology and policy, aiming to create a more inclusive financial ecosystem.

Evolution of Microfinance in India

The evolution of microfinance in India reflects a journey from informal credit systems to formalized and structured institutions. Below is a historical overview:

1. Pre-Independence Era

- **Informal Credit Systems**: Traditional moneylenders and community-based lending (e.g., rotating savings groups) were the primary sources of credit for rural and underserved populations.

- **Self-Help Practices**: Informal self-help groups (SHGs) and cooperatives emerged, fostering a culture of collective saving and borrowing.

2. Post-Independence (1950s–1980s)

- **Cooperative Movement**: The government promoted rural cooperatives to provide agricultural credit. However, inefficiencies and poor governance limited their effectiveness.

- **Nationalization of Banks (1969)**: Banks were mandated to prioritize rural and agricultural lending, laying the groundwork for financial inclusion.

- **Regional Rural Banks (RRBs, 1975)**: Established to bridge the gap between rural needs and formal banking systems.

- **Service Delivery Issues**: Despite these measures, credit delivery was hampered by bureaucratic hurdles, high transaction costs, and limited reach.

3. Emergence of Microfinance (1990s)

- **SHG-Bank Linkage Program (SBLP, 1992)**: Initiated by the National Bank for Agriculture and Rural Development (NABARD), this program linked self-help groups (SHGs) with banks, enabling access to formal credit.

➢ Encouraged savings and credit within groups.
➢ Became a significant driver of microfinance in rural areas.

- **Entry of NGOs**: Organizations like SEWA (Self-Employed Women's Association) and MYRADA introduced microcredit programs, focusing on empowering women and marginalized communities.

4. Growth Phase (2000s)

- **Microfinance Institutions (MFIs)**: Non-banking financial companies (NBFC-MFIs) and other entities started offering microcredit on a larger scale.

  Examples: SKS Microfinance (now Bharat Financial Inclusion), Bandhan, and Spandana.

- **Focus on Women**: Women-centric lending became a cornerstone of microfinance programs.

- **Policy Support**:

  - Reserve Bank of India (RBI) introduced regulatory measures for MFIs.
  - Government schemes like SGSY (Swarnjayanti Gram Swarozgar Yojana) integrated microfinance into poverty alleviation efforts.

5. Crisis and Consolidation (2010s)

- **Andhra Pradesh Crisis (2010)**: Over-indebtedness and aggressive recovery practices led to a backlash against MFIs in Andhra Pradesh, prompting stricter regulations.

  - RBI established guidelines on interest caps and grievance redressal.
  - Focus shifted toward sustainable practices and customer protection.

- **Transformation of MFIs**: Some MFIs transitioned into Small Finance Banks (SFBs) to offer diversified financial services.

  Examples: Bandhan Bank, Equitas Small Finance Bank.

6. Digital and Financial Inclusion Era (2015–Present)

- **Digital Revolution**:

  - Mobile technology and digital payments have transformed microfinance delivery.

  - Platforms like M-Pesa and Aadhaar-linked payment systems facilitated faster credit access.

- **Government Initiatives**:

  - **Jan Dhan Yojana (2014)**: Aimed at universal bank account access.

  - **MUDRA Scheme (2015)**: Provided loans to small entrepreneurs through microfinance channels.

- **Focus on Financial Literacy**: Emphasis on educating borrowers about responsible credit usage.

Association of Economic Growth through Microfinance with Sustainable Development Goals (SDGs)

In India, the integration of microfinance with development policies and digital technologies enhances its impact, making it a powerful tool for achieving sustainable development goals. Microfinance significantly contributes to achieving Sustainable Development Goals (SDGs) by addressing poverty, inequality, and financial exclusion. It supports various SDG goals with the help of Micro-finance schemes summarized in Table-1.

Table-1: Association of Microfinance with Sustainable Development Goals (SDGs)

SDG	**Goal Description**	**Contribution of Microfinance**	**Examples in India**
SDG 1: No Poverty	End poverty in all forms everywhere	- Provides financial resources for income-generating activities. - Enables investment in health, education, and housing.	Microloans to women in rural areas uplift families out of poverty.
SDG 2: Zero Hunger	End hunger and promote food security	- Offers loans for agricultural inputs (seeds, fertilizers, equipment). - Enhances food security through sustainable farming.	SHGs help farmers adopt modern farming techniques.
SDG 5: Gender Equality	Achieve gender equality and empower women	- Targets women borrowers for financial independence. - Encourages women's entrepreneurship and leadership.	SEWA supports women entrepreneurs in rural India.
SDG 8: Decent Work and Economic Growth	Promote inclusive and sustainable economic growth	- Facilitates entrepreneurship and self-employment opportunities. - Enhances financial inclusion for underserved communities.	The MUDRA scheme provides loans to small businesses.
SDG 9: Industry, Innovation, and Infrastructure	Build resilient infrastructure and promote innovation	- Funds small businesses and artisans. - Supports rural industries and innovation.	Microfinance-backed cooperatives grow handicrafts and rural industries.
SDG 10: Reduced Inequalities	Reduce inequality within and among countries	- Focuses on the financial inclusion of vulnerable groups. - Reduces income inequality by enabling wealth creation.	RRBs and MFIs bridge the urban-rural divide in access to credit.
SDG 12: Responsible Consumption and Production	Ensure sustainable consumption and production	- Promotes eco-friendly production methods. - Encourages responsible use of credit through financial literacy.	Loans for organic farming and sustainable crafts are offered by MFIs.
SDG 13: Climate Action	Combat climate change and its	- Provides green loans for renewable energy (solar panels, biogas, clean stoves).	Solar-powered irrigation loans reduce fossil fuel dependency.

	impacts	- Supports climate-resilient farming.	
SDG 16: Peace, Justice, and Strong Institutions	Promote justice and strong institutions	- Reduces vulnerability to exploitative practices. - Strengthens social bonds through community-based microfinance models.	SHGs foster social equity and conflict resolution in rural areas.
SDG 17: Partnerships for the Goals	Strengthen global partnerships	- Collaborates with governments, NGOs, and financial institutions. - Mobilizes resources for inclusive ecosystems.	SHG-Bank Linkage Program (SBLP) demonstrates effective partnerships in microfinance.

This table clearly shows how microfinance contributes to each Sustainable Development Goal while driving economic growth and fostering sustainable development.

Microfinance aligns closely with the SDGs by:

- **Promoting inclusive economic growth.**
- **Reducing inequalities.**
- **Empowering vulnerable groups.**
- **Encouraging sustainable practices.**

Comparative Cost analysis on Micro-credit facilitates by leading Public Sector Banks vs NBFC-MFIs

As per the "Master Circular – Deendayal Antyodaya Yojana - National Rural Livelihoods Mission (DAY-NRLM)" published on RBI 04/07/2018, DAY-NRLM has a provision for interest subvention, to cover the difference between the Lending Rate of the banks and 7%, on all credit from the banks/ financial institutions availed by women SHGs, for a maximum of ₹ 3,00,000 per SHG. And it is observed that some leading Public sector banks of India like Bank of Baroda, Bank of India, Bank of Maharashtra, Canara Bank, Indian Bank etc. who are in the top priority list of MFIN in terms of providing micro-credit to SHG members in rural India, they are religiously following the above interest subvention mentioned by DAY-NRLM. The regulation said that:

The interest subvention will be calculated and available across the country in two ways show in the below table-2:

Table-2: Comparison of Interest Subvention for Women SHGs under DAY-NRLM		
Feature	**Case 1: Identified 250 Districts**	**Case 2: Remaining Districts**

Loan Amount	Up to ₹3,00,000	Up to ₹3,00,000
Lending Rate by Banks (p.a.)	7%	Example: 10% (varies by bank)
Effective Interest Rate (p.a.)	4% (on prompt payment)	7% (after subvention)
Subvention Provided (p.a.)	Additional 3% (on prompt payment)	Difference between lending rate and 7%
Example: Total Interest (1 Year)		
- Interest at Lending Rate	₹21,000 (₹3,00,000 × 7%)	₹30,000 (₹3,00,000 × 10%)
- Interest After Effective Rate	₹12,000 (₹3,00,000 × 4%)	₹21,000 (₹3,00,000 × 7%)
- Subvention Amount	₹9,000 (₹21,000 - ₹12,000)	₹9,000 (₹30,000 - ₹21,000)
Implementing Agency	Directly through banks	State Rural Livelihoods Missions (SRLMs)

On the contrary, it is observed that top 5 NBFC-MFIs who are known as leaders of today's private micro-credit markets all around rural and semi-urban areas of the country are selling their micro-credit schemes at very high rate of interest and making huge profit. Below tables (Table-3 and Table-4) can give some idea about their social exploitation in the name of socio-economic growth.

Table-3: Details of leading five MFIs provide micro-credit to SHG members in various region of India

Institutions provide Micro-credit	**Average Rate of interest p.a.**	**Amount available**	**Processing fees**	**Tenure**	**Additional Information**
Bandhan Bank	22.95%	₹ 15,000	> 1.25% + GST for loans ₹25,000; > Nil for loans up to ₹25,000.	1 to 2 years	Weekly

CreditAccess Grameen	21.36%	Rs. 5,000/- to Rs. 1,50,000	1.27% + GST	Minimum 52 weeks to Maximum of 156 weeks	Weekly/two weekly/ monthly
Spandana Sphoorty	19.75% – 24.75%	Upto Rs. 80,000	1% + GST	Loan Tenure: 12 to 30 Months	Weekly / Monthly with no prepayment penalty
Ujjivan Small Finance Bank	23.00 % to 23.75%	Rs. 5,000 to 1,00,000	> "Nil" for loan up to 25,000, > 1.2% (+GST) or 1,100 (+GST) whichever is lower for loans above 25,000	6 months to 36 months	Monthly
Fusion Microfinance	19% - 23.80%	Upto Rs. 1,15,000	1.25% + GST	Up to 36 months	Weekly
Source: Official website of respective Institutions.					

Table-4: Details calculation of EMI charged by leading five MFIs provide micro-credit to SHG members

Institutions provide Micro-credit	**Number of Instalment considered as weekly**	**Average Rate of interest P.A.**	**Loan taken (Assume)**	**EMI/ Week**	**Total amount paid till final settlement**
Bandhan Bank	52	22.95%	15000	₹ 457.83	₹ 23,806.99
CreditAccess Grameen	52	21.36%	15000	₹ 444.65	₹ 23,122.01
Spandana Sphoorty	52	24.75%	15000	₹ 472.98	₹ 24,595.07
Ujjivan Small Finance Bank	52	23.75%	15000	₹ 464.53	₹ 24,155.60
Fusion Microfinance	52	23.18%	15000	₹ 459.75	₹ 23,906.95

Conclusion

Thus, we can say that in the name of social wellbeing NBFC-MFIs are creating a big question mark about how much the society; especially rural women are getting benefitted? Is there any need of strict regulation for all private Micro-finance providers to meet the SDG goals like End poverty in all forms everywhere, Achieve gender equality and empower women, Promote inclusive and sustainable economic growth, Build resilient infrastructure and promote innovation, Reduce inequality within and among countries, Promote justice and strong institutions etc.

The key challenges may arise for borrowers:

i) **Loan with High Cost or High rate of interest:** it is observed that charging high rate of interest to the micro-credit beneficiaries looks like a real burden for them in long run because of small repayment amount, large number of instalment, no early settlement policy etc.

ii) **Over-Indebtedness among Borrowers**: Borrowers often take multiple loans from different sources, leading to an unsustainable debt burden and difficulty in repayment, which can trap them in a cycle of poverty.

iii) **Financial Illiteracy**: lack of knowledge about formal banking process, fear of documentation process, Lack of understanding of cost calculation etc. maximum micro-credit borrowers feel comfortable to avail micro-credit from NBFC-MFIs, instead of having high cost and long run burden to pay instalments.

The key challenges may arise for Lenders:

i) **High Operational Costs for MFIs** : Microfinance institutions (MFIs) face high costs due to small loan sizes, frequent repayments, and the need for extensive fieldwork, which are passed on to borrowers through higher interest rates. High operational costs for MFIs.

ii) **Less recovery due to improper utilisation of loan:** there is no control over utilisation of loan amount by the micro-credit lenders. That's why its create deficiency in terms of income generation activities by beneficiaries and the aim of the MFIs high cost loan is actually not fulfil economic growth. So, they are taking other co-lateral free loans from other institutions for the purpose of repayment of the existing one.

iii) **Limited Access to Markets and Digital Infrastructure in Remote Areas**: In rural and remote regions, poor connectivity and lack of access to markets create hurdles look after utilization of loans effectively. So, it is limiting economic growth and repayment capacity as well

It can be concluded that to utilise the Micro-finance schemes as one of the key tool of economic growth, all concern commercial public and private sector banks, NBFC-MFIs should work together to follow some sets of policies with the help of NABARD, RBI and Government of India. It is essential to provide training to borrowers and lenders about the utilisation fin-tech, digital platforms, provide similar type documentation process to avail micro-credit, minimise the cost (high rate of interest), and arrange financial literacy campaign. Microfinance in India has transitioned from a grassroots movement to an essential component of financial inclusion, fostering empowerment, especially for rural women and small entrepreneurs; while challenges remain, innovations in technology and policy continue to shape its future.

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