IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 13, Issue 4 Ser. III (Jul. – Aug. 2022), PP 79-84
www.iosrjournals.org

A Study Of Micro Finance Banks, Micro Finance Institutions, And The Impact Of Increasing Digitalisation In The Generation Of Savings In Emerging Market Economies Like India

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ABSTRACT: *The study analyses the influence of microfinancing, that is mostly run by private enterprises in India, under the guidance of the Reserve Bank of India (RBI).This aims to provide finance to the poor who do not have any collateral. An attempt has been made to study whether this model has made a significant difference with respect to increasing incomes of the poor. Despite a growing number of such institutions there has simultaneously been an increase in the amount of distress. The paper tries to analyse the reasons behind this tragedy.*
RESEARCH QUESTION: The paper would attempt to analyse the impact of micro finance banks as well as microfinance institutions in the generation of the saving potential of an emerging market economy like India. It would also look at the effect of increasing digitalisation on enhancing the savings in the economy.

Date of Submission: 02-08-2022 Date of Acceptance: 15-08-2022

I. INTRODUCTION:

Both microfinance banks and microfinance institutions have been an important support system in the harnessing of savings potential in an economy that has not yet achieved a developed status. Microfinance is an individual focused community approach to provide money and financial services to poor individuals or small businesses that lack access to mainstream or conventional resources. Micro and macro finance represent two types of funding. Both aim at provision of credit to the citizens of the country. The difference lies in their area of coverage and the conditions under which money is disbursed. In the case of microfinance, the major institutions that come under its umbrella are all types of banks and other major financial institutions. These could be in both the public and the private sector. In the case of public sector, the majority stake is with the government, while in the case of private sector, the majority stakeholder is not the government, it could be a private individual and/or a consortium of financial companies, etc. Undermacrofinancing, any disbursement of credit requires a collateral. Without this, the debtor is unable to avail the loan. The system of microfinancing has developed with the primary aim of disbursement of loan to the poor who do not have any collateral. The microfinance banks and institutions which then developed did so to address this concern. The underdeveloped economy was facing a crisis with respect to low growth. The major reason was found to be the lack of credit to the poorest sections of society. It is to plug this concern that the microfinance sector started developing. In the process of development, there were many obstacles that came up which were attempted to be addressed and a new system of banking developed.

II. DEFINITION:

Microfinance banks and microfinance institutions indicate the provision of funds,to those set of borrowers, who do not have the required collateral to borrow money from macrofinancial banks and institutions.

Fig 1: A depiction of a typical microfinance institution in India

(Source: Google Images)

2.1. MICROFINANCE BANKS:

As the word indicates, these banks provide banking services to unemployed or low-income individual or groups who otherwise would have no access to financial services. It allows people to take on small business loan in a manner that is ethical. Banks are those institutions which create money, and their goal is to provide financial banking services to the people, money transfer deposits, withdrawals, and lending services etc. Such institutions include commercial banks, investment banks and microfinance banks. Microfinance banks in India can be divided into:

- Village Savings and Credit Associations (VISACAs)
- Finance Companies (FCs)
- Fiduciary Financial Institutions (FFIs)

One of the first initiatives to introduce microfinance was the Self-Employed Women's Association (SEWA) in Gujarat which was established in 1974. It has been providing financial services to people who need funds to grow their small business.

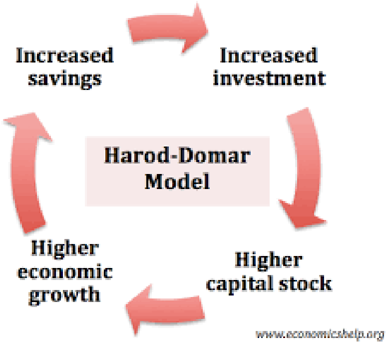
2.2. MICROFINANCE INSTITUTIONS

One of the successful microfinance institutions in India is the *Kudumbashree*. It was an initiative started by the Kerala government to eradicate poverty and was launched in the year 1988. This consisted of females belonging to a particular neighbourhood. Based on the neighbourhood, groups were formed that brought together women both in the rural and urban areas to fight for their rights on issues like health, nutrition, and agriculture. The reason that neighbourhood was emphasised was that the members of the group all knew each other. This meant commitment to the repayment of loans that they might take, was hundred percent. As every individual knew each other, the question of non-payment hardly arose. Another factor which worked with respect to minimum default was that by and large the members of the microfinance institutions were primarily women. It has been seen that defaulters amongst women are minimal.

III. GENERATION OF SAVINGS VIA THE MICROFINANCE BANKS AND INSTITUTIONS AND ITS IMPACT ON THE INDIAN GDP

All types of banksessentially increase the savings potential of an economy. They do this by providing a wide range of deposits, with varying combinations of liquidity and rate of interest, to suit the needs and preferences of different savers. The moment there is a growth of banking in unbanked and under-banked regions, the households' savings immediately increase. As the savings go up, there is an automatic increase of the investment that banks can make. In an underdeveloped economy where the accessibility to a bank is at times difficult, most savers keep their money in the form of cash. When this occurs, it is an automatic withdrawal from the system of potential investment. This can be easily recognised in the figure below:

Fig 2: Harrod-Domar Model of Saving



(Source: Google Images)

The Harrod-Domar model indicates that higher the savings that are generated, it would lead to increased investment, higher capital stock and subsequently higher economic growth. Savings is the most important aspect of achieving higher economic growth.Thus, it is very important for any economy to develop easy accessibility to a bank for all its citizens. This condition could be met either in the form of normal big-sized macro finance institutions or else with the help of microfinance institutions. For an economy like India where it is difficult for big commercial banks to reach every nook and corner of the economy, the support of microfinance banks and institutions can help in harnessing the savings of the poor as well as those citizens who stay in remote parts of the country.

Besides just the harnessing of savings, these institutions believe in the intrinsic ability of women to harness their business acumen. This is oneway of ensuring minimum default. Microfinance services target the poor and low-income households, and hence help them come out of poverty. They improve their income levels, their standard of living and most important help in women empowerment. Women are the most vulnerable group amongst the poor and the fact that they can believe in themselves and believe in their product gives them the confidence and courage and ability to stand up for themselves and their families.This sector in India has experienced phenomenal growth in the past decade, both in terms of institutions, as well as providing services,and the quantum of credit being delivered to customers.

This is aided by the following institutions:

- Scheduled Commercial Banks (SCBs)
- Small Finance Banks (SFBs)
- Regional Rural Banks (RRBs).
- Non-Bank Financial Companies (NBFCs)
- Microfinance Institutions (MFIs)

Table 1. Distribution of Loan Portfolio

Sr. No.	Parameters	Details	
1.	Loan Portfolio	Number of lenders	Percentage share
	Industry Level	197	100%
a)	Banks	15	40.99%
b)	NBFC-MFIs	86	30.80%
c)	SFBs	8	18.73%
d)	NBFCs	55	8.71%
e)	Non-profit MFIs	33	0.78%

(Source: rbi.org.in, publication; 14th June 2021)

The table above indicates the disbursement of loans to various financial institutions. The ones that are most important for microfinance lending are:

c)-SFBs

d)-NBFCs

e)-Non-profit MFIs

Microfinance institutions not only provide funds at flexible conditions, but they also encourage a quick application process. The amount disbursed are small. The essential underlying feature of these institutions is to help the poor and use this untapped opportunity to create markets. Bring people in from the margin and give them aids and tools to help them earn income.

The inequality in wealth distribution across the globe, means not only the unequal distribution of wealth among countries, i.e., developed economies vis-à-vis countries like sub-Saharan Africa, Nepal, etc, but also within countries an unequal distribution exists between the haves and the have-nots. Microfinance is one way where we can try and reduce this gap, and more than just providing money to the poor, it also provides services like savings accounts to mobile money, insurance services, healthcare, education, etc.

The owner of Grameen Bank in Bangladesh Mohammad Yunuswas amongst the first who realised the extent of benefit that could be reaped by providing small amounts of sums of money to women in a village to enhance their production. This was the first-time money was lent under the umbrella of the Grameen Bank. In India, there have been various other co-operatives that have been formed, but they are basically ones involved in the setting up of co-operatives to market commodities. Grameen Bank is the first one that functioned as a bank in providing finance to the poor without collateral at minimum interest rate. He was subsequently avoided the Nobel peace prize in 2006. Access to such financial services would help the poor to save for big expenses like weddings, funeral, school fees, businesses, assets, stream-line income streams, as well as manage risk. Normally the poor are turned away because they do not have any collateral or credit record or read or write to fill in forms for bank accounts and loans. Thus, there is a large section of society who are then marginalised and do not enter the production cycle. This also means that their savings are not available for the economy to enhance its investment, capital stock and GDP. This is a huge drain on the system. It is very essential to get them to be a part of the country's economic progress.

IV. CRITICAL IMPACT OF THE INSTITUTIONS IN THE GENERATION OF SAVINGS

As has been mentioned repeatedly, the use of microfinance banks and institutions will go a long way in generating the untapped savings of the poorest sections in society. It is very important to tap their potential.

Increased savings ⇒ Increased investment ⇒ Increased GDP.

To ignore this important section of societywould lead to untapped resources for the economy. For the economy to grow, it is important to unleash the productive capacity of poor people who are dependent on self-employment. Once the microfinance sector starts growing, it paves the way for other forms of social enterprise and social investment. The microfinance sector has grown since 1990s, but it has not had a sustainable growth. Microfinance yields benefits by providing liquidity for a wider range of needs, but it does not help in finding source of income for the poor. It does not help in increasing job opportunities. It only helps solving issues, where there is already a source of income and there is a marketable product. The only bottleneck is finance, it is here that microfinance institutions play an important role.

Microfinance has been acknowledged for introduction of innovations particularly with respect to group lending and instalment lending (Ghatak and Guinnane,1999, Armendariz and Morduch, 2000). It is a new method of development instead of all the burden of provision of funds to the marginalised sections being provided by the central government.It is these institutions whicheventually follow market mechanismto deliver services, in a manner that synergises the social and financial goals of an emerging market economy (Conning and Morduch, 2011).

In recent years, what has been noticed is that microfinance is a useful financial service, butit has not helped much with respect to improvement of social and economic conditions of the poor. Some of the reasons that have been expounded are that these institutions were more concerned with profit maximisation rather than focusing on improvement of households. Microfinance was supposed to overcome financial constraints and as said earlier, this would then increase the opportunities of earning. The interest rates charged by these institutions would be at a much cheaper rate than local money lenders. The vision of this system of finance was to increase income and with finance no longer being a constraint, it would help in improving the health and education levels of women, thus empowering them to reach greater heights. The picture that was painted was that finance would be seen as a tool of personal transformation of the economies. Several researchers have not found sufficient evidence that has indicated that microfinance has reduced poverty or improved living conditions or helped in the mushrooming of small businesses.Microfinance alone cannot achieve the vision that has been mentioned above.It is a combination of effort by the government to bring together saving, insurance, payment services in those communities which do not have the privilege of such services. Thus, there must be a broadening of the vision of microfinance itself. As they provide finance at a cheaper rate, it makes sense for the government to subsidise their funds and thus help households to move above the poverty line.

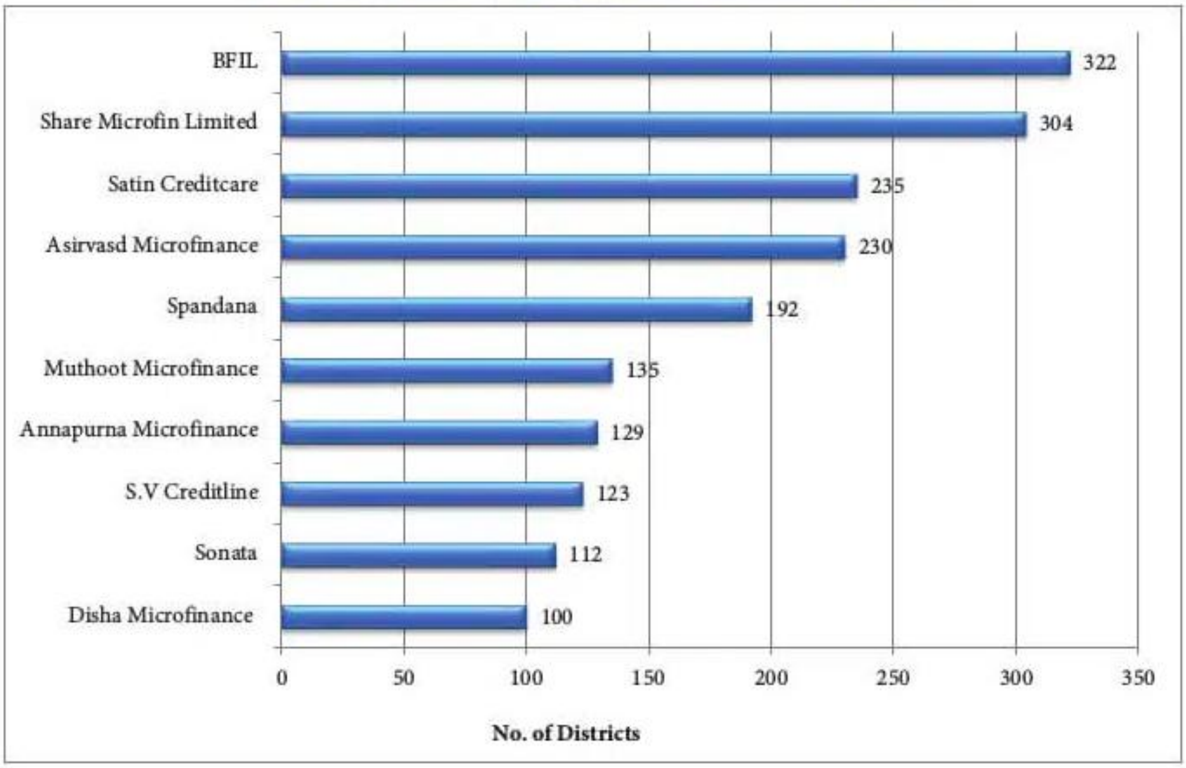
There have been cases when people have over borrowed way above their means, resulting in defaulting on their dues. This has led to adebt crisis,resulting in suicides, further resulting in scarceexpensive financial resources.

Microfinance is emerging as a fast-growing sector. It has not been able to adequately reach out to each and everyone in the country. There is a lot of scope for improved penetration of this sector. Studies have indicated that the microfinance in India has the potential to grow at a Compound Annual Growth Rate (CAGR) of 40% by 2025.

The National Bank of Agriculture and Rural Development (NBARD) promotes advances to Self-Help Groups (SHGs) so that they could start providing loans to small gathering of women who are small entrepreneurs. In 1993, the RasthriyaMahila (RMK or the National Credit Fund for Women) was established to provide credit to independently employed ladies in the unorganised sector and NGOs. The government has continued to encourage different microfinance institutes in India, for example, Small Industries Development Bank of India (SIDBI), this started off with an underlying capital of 100 crores, given by the government.Regional Rural Banks (RRBs) were also developed.Over the years it was discovered that the rural banks were only serving the wealthier, regional customers and 87% of the poorest family units (small agriculturists) were unable to access funds. A survey done by the World Bank, National Council of Applied Economic Research (NCAER), Rural Finance Access Survey (RFAS 2003) indicated that 71% of the poor family units did not have a saving account, more than 82% of the family studied in RFAS 2003 did not have insurance and none of the poorest families had protection (Basu 2006).

In 2004 and 2005, the planning commission estimated that 75% of the poor live in rural areas. These comprised of landless labourers, daily wagers, and independently employed families. India, at that time had the largest number of people in the world living below the poverty line and at the same prime period, the gap between the rich and the poor were widening.It has been discovered that it is the mutual fund institutions, who have increased their branches are the onesproviding finance to the rural poor through small finance banks. They have also branched into streams like Suryoday, Utkarsh, and Janalakshmi and have increased thenumber of branchesin various districts.

Table 2: Top 10 Microfinance Institutions (MFIs) in Number of Indian Districts



Source: (The Bharat Microfinance Report 2017)

The Reserve Bank of India (RBI) have allowed microfinance institutions (MFIs) to set their own interest rates provided they are not exorbitant.

V. IMPACT OF INCREASED DIGITALISATION SPECIALLY DURING THE COVID-19 PANDEMIC

Digitalisation of MFIs have reduced costs with respect to storage of physical data and has also reduced the time for processing and collecting repayments. As repayment of principal and interest can take place via mobile phones, it has reduced the risks of cash in transit. All this is a part of newer technology being applied to the financial services industry and has improved the way of working of MFIs.

The emphasis on bank accounts for all citizens in India has helped in the transfer of funds to the women in the rural areas. The women are responsible for the loans that they take and can stand up to the men in case they do not want to share the loan amount. The emphasis on individual banks accounts for all beneficiaries haveincreased the reach of the banking system in India.

The government of India has instituted several schemes for women, but the underlying premise is that they need a bank account based on their Aadhar Card. This avoids misuse of funds of the recipient.

Covid-19 increased the miseries of the poor and especially the rural poor, but the spread of banking facilities and the requirement of bank account by all has led to an increase in banks being available till the last mile. The silver lining to the pandemic was that it became necessary for all to open a bank account if they wanted to avail off the facilities that were being provided by the government. In the bargain, there was increased digitalisation which helped the microfinance sector too.

VI. CONCLUSION

Initially, the microfinance grew very fast, but slowly what was seen was a relative and absolute decline with respect to money being transferred to the poorest customers. Most of the microfinance companies are privately owned, though they are regulated by strict RBI guidelines. There have been instances where to further their own business, these companies have encouraged small lenders to borrow more and more funds which is way beyond their capability of returning. This has led to a debt crisis whereby the borrower continues to borrow more from conventional and unconventional lenders, at times paying very high rates of interest to get out of the loan-interest-debt-trap. When this increases way beyond their control it may culminate in suicide. What is important is that along with funds, the borrower should be encouraged to skill himself/herself such that this would eventually be the source of livelihood. The government and other stakeholders should work in this direction to prevent unnecessary taking of lives by debtors.

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