UPSC Civil Services Examination

UPSC Notes [GS-II]

Topic: Micro Finance - Micro Finance in India

Microfinance is a basis of financial services for entrepreneurs and small businesses deficient in contact with banking and associated services. The two key systems for the release of financial services to such customers include 'relationship-based banking' for individual entrepreneurs and small businesses along with 'group-based models' where several entrepreneurs come together to apply for loans and other services as a group. Similar to banking operation traditions, microfinance entities are supposed to charge their lender's interests on loans. In most cases the so-called interest rates are lower than those charged by normal banks, certain rivals of this concept accuse microfinance entities of creating gain by manipulating the poor people's money.

As per the World Bank estimates, more than 500 million people have improved their economic conditions via microfinance-related entities. Microfinance is an important topic for the IAS Exam and is included under the GS-II section of the UPSC Syllabus.

History of Microfinance

The history of microfinance can be traced back to the middle of the 1800s. During the 1800s, the benefits of small credits to entrepreneurs and farmers was written by Lysander Spooner, the theorist, as a way to get people out of poverty. Later, the first cooperative lending bank was founded independently by Friedrich Wilhelm Raiffeisen to support the farmers in rural Germany.

The term **"microfinancing"** was first used in the 1970s during the development of Grameen Bank of Bangladesh, which was founded by the microfinance pioneer, Muhammad Yunus. In 1976, Yunus institutionalized the approaches of microfinance, along with the foundation of Grameen Bank in

Bangladesh. Since, in the developing countries, a large number of people still depends largely on subsistence farming or basic food trade for their livelihood, therefore, smallholder agriculture in these developing countries has been supported by the significant resources.

Microfinance in India

Lack of security and high operating costs are some of the major limitations faced by the banks while providing loans to poor people. These limitations led to the development of microfinance in India as an alternative to provide loans to the poor with an aim to create financial inclusion and equality.

SEWA Cooperative Bank was initiated in 1974 in Ahmedabad, Gujarat, by Ela Bhatt which is now one of the first modern-day microfinance institutions of the country. The National Bank for Agriculture and Rural Development (NABARD) offered financial services to the unbanked people, especially women and later decided to experiment with a very different model, which is now popularly known as Self-help Groups (SHGs). The SHG-Bank linkage programme in India has savings accounts with 7.9 million SHGs and involves the participation of regional rural banks (RRBs), commercial banks and cooperative banks in its operations. The origin of SHGs in India can be traced back to the establishment of the Self-Employed Women's Association (SEWA) in 1972.

To know more on Self-help Groups (SHGs), refer to the linked page.

In 2013, a loan of $144 million was provided by Grameen Capital India to the microfinance groups. Apart from the Grameen Bank, another microfinance organization named Equitas was developed in Tamil Nadu. The Southern and Western states of India are the ones attracting the greatest number of microfinance loans.

What is MUDRA?

The central government had introduced the Micro Units Development Refinance Agency (MUDRA) where the scheme aims to refinance collateral-free loans of up to Rs 10 lakh granted by lending entities to non-corporate small borrowers, for revenue growth actions in the non-farm sector. Currently, loans granted under this system have falls under three categories namely, Shishu loans for up to Rs 50,000, Kishor loans in a range between Rs 50,001 to Rs 5 lakhs and Tarun loans ranging from Rs 5 lakhs to 10 lakhs. As a way to make the MUDRA scheme popular, the government aims to set up a Rs 3000-crore Credit Guarantee Fund to back these loans.

Benefits of Microfinance

As per the World Bank estimates, more than 500 million people have improved their economic conditions via microfinance-related entities. Also, the International Finance Corporation (IFC) estimated that, as of 2014, over 130 million people were directly benefited from the microfinance-related operations. But, approximately only 20% of the three billion people who fall under the category of the world's poor can avail these microfinance operations. IFC also helped in establishing or improving the credit reporting bureaus in 30 developing nations.

Microfinance is also a source of capital for the people. It also empowers women in particular, which may lead to more stability and prosperity for families.

Microfinance is an important topic in the General Studies Paper-II of the UPSC exam. Questions can be asked from this topic in both the IAS prelims as well as the IAS mains exams. Candidates preparing for the UPSC 2020 should keep a track of the latest current affairs topics related to any economic development in the country.