The role of microfinance in building a resilient India

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Years ago, when I used to work for a non-government organization in Bengal, I would travel deep within the state and speak to economically-underprivileged people in rural areas to try and understand the challenges they faced. On one such visit, I met a woman residing in a mud-house, who was cooking, even as I was speaking to her. I tried to educate her about the benefits of health, hygiene and education, but she seemed uninterested in what I had to share. After a while, I was intrigued to ask her why she wasn't paying attention. Even as she kept cooking, she told me that her daughter had been craving some fish curry and rice for the past few days, which she couldn't provide as she didn't have the money. All that she could think of at that moment was what new excuse to offer for failing to fulfil her wish yet again.

This meeting, and my overall experience of witnessing the hardships of the poor first-hand, made me realize that social development can only follow once people have an opportunity to build a sustainable livelihood for themselves. It is with this objective in mind that I founded Bandhan two decades ago, to serve the twin and interlinked purposes of women empowerment and poverty alleviation.

Over these years, no other form of financial services has had the kind of far-reaching impact, in terms of fostering financial inclusion, as microcredit has. Access to small, collateral-free loans for economically productive purposes has helped transform the lives of millions at the bottom-of-the-pyramid—especially women. It has helped free them from the clutches of informal moneylenders who would charge exorbitant rates of interest, usurp collateral in the form of land, gold or other assets, and perpetuate a cycle of indebtedness and poverty.

That microfinance ably serves its purpose is evident from the fact that despite several challenges along the way, the industry has not only survived, but grown significantly. Over the past decade, India's microfinance industry has grown at a compound annual growth rate of 26% to reach ₹2.36 trillion. It has helped 50 million economically vulnerable Indians, 99% of them women, live a life of dignity and financial independence. Assuming that these 50 million people who took a loan to start a small business employed at least one other person, it translates into 50 million additional jobs in the country. This creates a 'network effect' that has a social impact at scale. Is there any other industry that could have supported these people—who are poor, have little or no assets to their names, and no proper documentation needed for traditional credit—in the manner that microcredit did? It's doubtful.

Sure, there have been hurdles along the way. But the industry's inherent resilience, which it draws from robust demand among people at the grassroots looking for some hand-holding to shape their lives, has made it stronger. Several events over the years—a crisis in Andhra Pradesh in 2010; demonetization in 2016; cyclones and floods in various Indian states—have failed to dent the industry, which continues to serve a vital need.

QUICK READ

Microcredit has had the most far-reaching impact on financial inclusion in India. The money lent has created millions of jobs and the industry itself has grown robustly in the past two decades.

Micro-lenders have more to do. Among other things, they ought to promote financial literacy, complement their core work with social development projects and improve their risk assessments.

Recommendations of the Malegam Committee constituted by the Reserve Bank of India (RBI), which became regulations, and practices such as relying on credit bureau data to assess a borrower's creditworthiness have helped the industry immensely. The vital role that microfinance plays in the last-mile delivery of financial services was acknowledged, and that is why an institution like Bandhan Bank was given a banking licence. Subsequently, eight out of the 10 small finance bank licences granted were also given to microfinance institutions.

Like everything else in life, the microcredit sector is evolving. It is indeed heartening to note that RBI has sought to undertake a comprehensive review of the sector again, after 10 years, to better align the regulatory framework with the sector's current realities.

Going forward, entities engaged in microfinance need to focus on a few specific tasks for the holistic development of the sector. One of them is to promote financial literacy through group meetings of borrowers. Second, organizations should complement their microcredit operations with social development projects and community-connect initiatives. Third, prospective borrowers' indebtedness and ability to repay dues should be assessed properly. Fourth, loans must be given only for income-generation purposes. Fifth, every microfinance organization should devote time and resources for capacity building at the grassroots. And last but not least, rather than focusing on taking over the existing debt of a borrower, or lending to her further, institutions should focus on bringing new-to-credit customers into the fold.

The two decades that I have spent in developmental finance have been highly fulfilling. There is no better feeling than to see smiles on the faces of people whose lives have been improved by access to organized-sector finance. But the journey has only just begun, and there is much more that we, as a nation, collectively need to do in order to bring a vast population of unbanked and underbanked Indians into the fold of formal financial services.

These are the author's personal views.