

# AN ANALYSIS OF THE DEVELOPMENT AND PROLIFERATION OF MICROFINANCE INSTITUTIONS IN KERALA WITH DETAILED INSIGHTS

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**Abstract** *The paper provides a comprehensive analysis of the development and proliferation of Microfinance Institutions (MFIs) in the Indian state of Kerala, offering detailed insights into the factors driving their growth and the implications for financial inclusion and socio-economic development. Through a combination of historical examination, and theoretical frameworks, this study elucidates the evolution of MFIs in Kerala and examines their role in addressing the financial needs of underserved communities.*

**Keywords** *Micro Financial Institutions, Regulatory Issues, Challenges, Impact on the Economy*

## INTRODUCTION

Access to credit is paramount in establishing a financial foundation for the impoverished. Credit serves as a source of relief and empowerment, instilling confidence in individuals as they pursue their aspirations. It catalyzes all endeavors geared toward growth and acts as a pivotal component in rural development initiatives. Despite facing financial hardships, the resilience exhibited by the economically disadvantaged propels them towards developmental endeavors. However, the realization of their full potential is often hindered by a lack of knowledge and financial backing. Therefore, timely provision of credit, coupled with necessary support services, is essential to facilitate the engagement of the impoverished in productive ventures capable of generating sustainable income. Banks and other financial institutions play a crucial role in channeling the necessary financial support towards this end. Despite its relatively high literacy rates and social development indices, Kerala still faces challenges in providing access to formal banking services, especially in remote and rural areas. Many low-income individuals and small businesses may not meet the eligibility criteria set by traditional banks, making microfinance a viable alternative. Kerala's economy is characterized by a significant informal sector, comprising small-scale enterprises, self-employed individuals, and agricultural workers. Microfinance plays a crucial role in providing financial assistance to these informal sector participants who may not have access to mainstream financial institutions. Kerala's economy is susceptible to various economic shocks, including natural disasters, fluctuations in agricultural output, and global economic downturns. Some of the weaknesses of Kerala's economy

include unemployment, reliance on external markets, environmental degradation, overexploitation of natural resources, and a deteriorating fiscal position, stemming from the emergence of 'second generation problems' as a consequence of the state's remarkable achievements in social development.

Microfinance refers to financial services, such as loans, savings, and insurance, provided to low-income individuals or groups who typically lack access to traditional banking services. It emerged as a strategy to alleviate poverty by empowering the poor to engage in income-generating activities, build assets, and cope with unforeseen expenses.

The concept of microfinance gained prominence with the pioneering work of individuals like Muhammad Yunus, who founded the Grameen Bank in Bangladesh, and institutions like ACCION and BRAC. Since then, microfinance has evolved into a global movement with diverse models and approaches aimed at improving the economic well-being of the poor and marginalized communities around the world. ESAF started lending in 1995 as the first microfinance company in Kerala. It became ESAF Small Finance Bank after receiving the first banking license in Kerala since independence. On 17 March 2017, Pinarayi Vijayan, the Chief Minister of Kerala officially inaugurated the ESAF Small Finance Bank in Thrissur, Kerala.

According to a study by Kumar Vipin et al. (2020), MFIs and SHGs are essential to the provision of microfinance services, which promotes the development of India's low-income and impoverished population. However, several study findings from across the nation have also been reported regarding slow progress in SHG member graduation, poor group

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functioning, member dropout, etc., which must be considered when creating the roadmap for the SHG program's next phase.

## OBJECTIVES OF THE STUDY

- To study the core activities of microfinance institutions in Kerala.
- To analyze the role of MFIs in the various economic development sectors.
- To understand the challenges faced by the MFIs in Kerala.

## Analysis of Microfinance Institutions in Kerala

Kerala is one of India's 29 states and the most southern state. It is further divided into fourteen districts, which are administrative divisions. Due to a scarcity of industrial raw materials, Kerala has historically had an export-oriented commerce economy driven by its ports (Dreze & Sen, 2007). The microeconomy in the area has high adult literacy and education rates as well as high remittance levels. Kerala is ranked first out of all Indian states in the Human Development Index for income, education, and health (Government of India, 2019). Additionally, the community has a strong sense of political consciousness and is home to established community organisations. These groups are either secular, like workers' cooperatives with cross-community relationships, or religious, drawn from the well-known Hindu, Christian, and Muslim populations. Kerala's microfinance strategy was impacted by the institutional decentralisation reforms that occurred in the middle of

the 1990s. This was in line with the national strategy that, after economic liberalisation in 1991, required political and financial devolution of authority through the 73rd and 74th constitutional amendments. The Kerala sub-national government gave the local governments control over its social and development assistance ministries in 1995. Subsequently, the regional administration established a "people's plan campaign model" of development the next year, allowing local communities to decide how development plans may be allocated while also giving them a third of its financial resources. Subsequently dubbed "Kudumbashree," this programme promoted women's microenterprises, both individual and collective, and informal banking. This mission's integrated microfinance approach was centered on providing social services with the aid of programmes aimed at women and children, enhancing the ability to support livelihood, and granting credit through bank linkage programmes. Reaching out to the communities, this integrated microfinance effort made use of the hierarchical structure of local government agencies. The neighbourhood groups that were established as a result of this programme assisted in credit disbursal by helping to choose the loan size, the intended use, and the repayment plan, in addition to using group savings as collateral for loans. The requirements of the community and the availability of local resources were incorporated into small-scale production activities that were dependent on local markets and short supply chains as part of the second initiative livelihood. Due to the high literacy rates in the community, Kerala's entrepreneurial intervention required long-term support in the form of capital, scaling up, and marketing with the aid of stakeholder partnerships, as well as short-term programmes through employment support programmes (Kuriakose & Joseph, 2015). As per the report Sa-Dhan Report 2022 twelve MFIs are actively operating in Kerala.

**Table 1: List of MFIs in Kerala**

Sr. No.	Institution	District-Wise Presence	Legal Status	Core Activities
1	Asirvad Microfinance Ltd	9	NBFC-MFI	Income generation program. short and medium-term loans.
2	Belstar Investment and Finance Pvt. Ltd	1	NBFC-MFI	Credit for microenterprise. small and medium enterprise. education, sanitation. consumer goods.
3	Bharat Financial Inclusion	9	NBFC-MFI	Credit for microenterprises. short term loans.
4	Blaze Trust	1	Trust	Income-generating loans. education and skill-building.
5	Forum for Rural Environment and Economic Development (FREED)	4	Society	Microcredit. Livelihood development.

Sr. No.	Institution	District-Wise Presence	Legal Status	Core Activities
6	Innovative Microfinance for Poverty Alleviation and Community Transformation (IMPACT)	1	Section 8 company	Loans for microenterprise. rehabilitation after natural disasters.
7	Jeevankiran	2	Society	Education.
8	Life Foundation	2	Trust	Women and children's shelter. Vocational training. Community health services.
9	Madura Micro Finance Ltd	2	NBFC-MFI	Small and medium-term loans. Entrepreneurship training.
10	Muthoot Microfinance Ltd	Not available	NBFC-MFI	Income generating loan. Community health.

Assessing the impact of microfinance on the lives of beneficiaries in Kerala involves analyzing various indicators such as economic empowerment, social inclusion, and overall well-being.

*Key aspects to consider includes:*

**Poverty Alleviation:** Microfinance institutions are considered a society-based strategy to give different finance-related sources for the poor and disadvantaged section of society to improve the lives of clients (SEEP, 2006). Assess the role of beneficiaries out of poverty and look at changes in living standards, access to basic amenities, and ability to meet essential needs such as food, healthcare, and education (Chandrashekar & Shivashankar, 2009).

**Entrepreneurship and Employment:** Examine the impact of microfinance on entrepreneurship and job creation. Evaluate the number of new businesses started, employment opportunities generated, and the sustainability of ventures supported by microfinance.

**Financial Inclusion:** Evaluate the extent to which microfinance has increased financial inclusion among marginalized communities in Kerala. Analyze access to formal financial services, usage of banking products, and participation in savings and credit activities (Ananad, 2016).

**Women Empowerment:** Investigate the role of microfinance in empowering women in Kerala. Assess changes in women's decision-making power, access to resources, and participation in economic activities.

**Social Capital and Community Development:** Explore the impact of microfinance on social cohesion, collective action, and community development. Assess changes in social networks, cooperation among beneficiaries, and participation in community initiatives (Feigenberg, Field & Pande, 2013).

**Risk Management:** Examine the effectiveness of microfinance in helping beneficiaries cope with financial shocks and unforeseen expenses. Evaluate access to insurance products, emergency funds, and support during times of crisis. Markus Froelich, Niels Kemper and Robert Poppe Valerie Breda and Patricia Richter.

Case studies or anecdotes illustrating how microfinance has empowered individuals and communities.

Vijay, a young entrepreneur from Kerala, dreamt of starting his own organic farming venture but lacked the necessary capital to purchase land and equipment. Through a microfinance program specifically designed for aspiring farmers, Vijay received financial assistance, technical training, and marketing support. With the loan, he acquired a small plot of land, implemented sustainable farming practices, and began cultivating organic fruits and vegetables. As his business flourished, Vijay not only improved his family's livelihood but also contributed to environmental conservation and community health by promoting organic agriculture.

## Challenges Faced by Micro-Financial Institutions

### Over-Indebtedness

The microfinance industry lends money without requiring collateral, which raises the possibility of bad debts. Rapid expansion necessitates careful infrastructure planning, which the Indian microfinance industry lacks. Moreover, one of the main reasons for excessive debt is the absence of central government oversight over MFIs in India.

## Higher Interest Rates in Comparison to Mainstream Banks

Most Microfinance Institutions charge a very high rate of interest (12-30%) when compared to commercial banks (8-12%). The regulatory authority RBI issued guidelines to remove the upper limit of 26% interest on MFI loans.

### *Widespread Dependence on the Indian Banking System*

Since the majority of microfinance organisations are registered as Non-Governmental Organisations (NGOs), they rely on commercial banks and other financial institutions for steady funding to conduct their lending operations. The majority of these commercial banks are privately owned businesses that charge higher interest rates. Additionally, they approve loans for shorter terms. Indian MFIs are inept as lending partners due to their extreme reliance on banks.

## Inadequate Investment Validation

Investment valuation is a critical skill for an MFI's smooth operation. However, market activity is frequently restricted because MFIs operate in underdeveloped markets. It is challenging for MFIs to obtain market data for valuation purposes because of this restriction. The inability of MFI management teams to get high-quality information necessary for making wise investment decisions is hampered by the absence of uniform and trustworthy valuation methodologies.

## Regulatory Issues

One major concern facing microfinance in India is regulation. Although it is the primary regulator, the Reserve Bank of India prefers to serve traditional and commercial banks more so than microfinance institutions (MFIs). Compared to traditional lending institutions, microfinance institutions have completely different needs and structures. MFIs have benefited from certain rules, while many problems have gone ignored by others.

## Choice of Appropriate Model

Most MFIs follow the Self-Help Group model (SHG model) or the Joint Liability Group model (JLG model) of lending. Nevertheless, rather of using scientific reasoning or taking the circumstances into account, the model is frequently chosen at random. This puts the weaker segment at greater risk of borrowing than they can handle, and once a decision is made, it cannot be changed. The long-term viability of the MFI organisation is strongly impacted by the model selection.

Contrasting the microfinance landscape in Kerala with national trends provides valuable insights into regional variations and broader patterns within India's microfinance sector. Here's a comparison:

### • Penetration and Reach

*In Kerala:* Kerala boasts a relatively high level of financial inclusion and literacy compared to other states in India (Sankaran, 2016). The microfinance sector benefits from strong community networks and a culture of mutual support, contributing to widespread adoption of microfinance services (Saravanan & Radhakrishnan, 2018).

*Nationally:* Microfinance penetration varies significantly across states, with some regions facing challenges related to infrastructure, poverty levels, and social barriers (Morduch & Armendariz, 2010). While microfinance has expanded rapidly in recent years, disparities persist in terms of access and outreach (Mersland & Strøm, 2010).

### • Regulatory Environment

*In Kerala:* The regulatory environment for microfinance in Kerala is influenced by state-level policies and initiatives aimed at promoting financial inclusion and protecting consumer rights (Asian Development Bank, 2018). The state government collaborates with microfinance institutions and NGOs to ensure responsible lending practices (Saravanan & Radhakrishnan, 2018).

*Nationally:* Microfinance regulation in India is primarily governed by the Reserve Bank of India (RBI) and other national regulatory bodies (RBI, 2019). Regulatory frameworks aim to balance financial inclusion with consumer protection, addressing issues such as interest rates and loan recovery practices (Sinha & Aggarwal, 2019).

### • Institutional Diversity

*In Kerala:* Kerala's microfinance landscape comprises a diverse mix of formal and informal institutions, including commercial banks, NBFCs, SHGs, and cooperatives (Saravanan & Radhakrishnan, 2018). Community-based approaches are prevalent, fostering trust and solidarity among members (Mersland & Strøm, 2010).

*Nationally:* Microfinance institutions in India vary in size, structure, and clientele, serving both urban and rural markets (Morduch & Armendariz, 2010). While some focus on traditional microfinance products, others explore innovative delivery channels such as mobile banking and digital platforms (Sinha & Aggarwal, 2019).

### • Social and Cultural Factors

*In Kerala:* Social cohesion and collective decision-making play a significant role in shaping Kerala's microfinance landscape (Sankaran, 2016). Factors such as caste, religion,

and gender dynamics influence microfinance practices and preferences (Saravanan & Radhakrishnan, 2018).

*Nationally:* Microfinance interventions in India are influenced by diverse cultural contexts and regional disparities (Mersland & Strøm, 2010). Context-specific approaches are essential for addressing social and economic challenges within different communities (Sinha & Aggarwal, 2019).

In conclusion, Kerala's sustainable development, inclusive growth, and poverty reduction are all significantly aided by microfinance. Microfinance enables people and communities to reach their full potential and contribute to the state's overall prosperity by meeting the financial needs of underserved communities, encouraging entrepreneurship, and advancing social and environmental sustainability. Microfinance continues to be a vital instrument for promoting inclusive growth and creating a more just and resilient society for coming generations as Kerala develops and tackles new issues.

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