ISSN (Online) : 2456-9062

ISBR MANAGEMENT JOURNAL
June 2024, Vol 9(01), 52 – 60
DOI: 10.52184/isbrmj.v9i01.000

Role of Micro Finance Institutions in Promoting Financial Inclusion – A Study In Raichur, Bidar and Chamarajanagar

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Article Type: Research Article

Article Citation: Rajput K.G and Dr. M R Jhansi Rani, Role of Micro Finance Institutions in Promoting Financial Inclusion – A Study In Raichur, Bidar and Chamarajanagar. 2024;9(01),52-60. DOI: 10.52184/isbrmj.v9i01.000

Received date: March 21, 2024

Accepted date: May 30, 2024

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Abstract

The transition from unbanked to banked status is critical for rural communities, and microfinance plays a vital role in this transformation, particularly in regions like Karnataka. This study, focusing on Raichur, Bidar, and Chamarajanagar, examines the impact of microfinance institutions on financial inclusion. With a sample size of 610, data was collected using questionnaires and analyzed using various statistical tools. Findings reveal that while financial inclusion goes beyond account opening to regular usage and access to credit, many villagers still depend on moneylenders. Surprisingly, none of the sample villages achieved Financially Inclusive status. Recommendations emphasize the urgent need for equitable access to financial services, including heightened awareness through financial literacy programs and the establishment of bank branches in remote areas. The study highlights the collective responsibility in promoting inclusive growth, urging citizens to contribute to the financial empowerment of rural communities. By implementing recommendations effectively, the study envisions a future where financial inclusion becomes a reality, fostering economic prosperity in rural Karnataka and beyond.

Keywords: Financial Inclusion, Unbanked to Banked, Empowerment, Microfinance

1. Introduction

Microfinance involves offering financial services to low-income individuals, especially women in developing nations, with the goal of alleviating destitution, empowering women, and promoting advancement in society and the economy. The services provided included deposits, loans, payment services, money transfers, and insurance.

Muhammad Yunus defines microfinance as providing small loans to impoverished individuals to support their self-employment endeavors, which produce money for them to sustain themselves and their families.

Microfinance, as defined by ACCION International, involves offering small loans to businesses that do not qualify for traditional bank loans due to their extreme poverty. It necessitates building a robust credit score and the ability to repay loans with interest. Microfinance, as defined by the United Nations Capital Development Fund (UNCDF), is an entrepreneurship approach that provides financial services to those with limited incomes through organizations.

The definitions above, which share similar perspectives on microfinance with some variations, suggest that microfinance is associated with:

- Empowerment
- Financial inclusion
- Small loans
- Diverse financial services
- Social impact

Financial inclusion is providing essential cash management services to all individuals in society, particularly those excluded by traditional banking institutions. Financial inclusion seeks to offer individuals and businesses access to a range of banking services and products that meet their requirements, regardless of their financial situation.

Key components of financial inclusion include:

1. **Banking Services:** Offering consumers access to fundamental banking services including savings accounts, checking accounts, and other financial products.
2. **Credit Facilities:** Providing credit facilities to provide access to credit and loans for people and enterprises, particularly in marginalized or low-income areas.
3. **Insurance Products:** Providing cost-effective and pertinent insurance solutions to safeguard people and organizations from diverse dangers.
4. **Payment Systems:** Improving efficient and secure payment methods, such as digital transactions, to boost financial connectedness.
5. **Financial Education:** Enhancing financial literacy and education to enable people to make well-informed choices on their finances.

Financial inclusion is seen as a crucial instrument for diminishing poverty and fostering economic growth. It strives to provide a more inclusive and fair financial system that benefits all individuals in society, promoting economic development and stability.

Financial inclusion is crucial for economic development and progress, especially in areas where the conventional banking system is not easily accessible or is not well-established. The transition from being "unbanked" to "banked" is a transforming process for people, families, and communities since it provides access to formal financial services. Innovative financial mechanisms such as microfinance play a crucial role in financial re-intermediation, particularly in rural regions like Karnataka (Gulabsing & Rani, 2022).

2. Review of Literature

The review of literature is a critical component of any academic research, as it provides a comprehensive overview of existing knowledge and research related to the chosen topic. In the case of "Role of microfinance institutions (MFIs) in promoting financial inclusion- a study in Raichur, Bidar and Chamarajanagar," the literature review should set the stage by summarizing key studies, concepts, and theories relevant to financial inclusion, microfinance, and the specific context of rural Karnataka.

Ozdemir et al. (2023). This research provides a thorough analysis of Islamic microfinance in Turkey from the viewpoints of participating bankers, Islamic microfinance institution (MFI) administrators, representatives of regulatory bodies, and scholars of sharia. The proposed approach fills a vacuum in the literature on Islamic microfinance in Turkey and offers PBs useful guidance on how to strengthen their social responsibility and encourage low-income people's financial inclusion.

Banna et al. (2022). Fintech innovations were rapidly transforming the worldwide financial system and aiding MFIs in their endeavors to extend financial access to marginalized groups. It was anticipated that these technological improvements would contribute to the reliability of the banking industry, and as a result, lower the inclination of the system's primary players to engage in risky behavior. However, there was a lack of experimental data to substantiate the claim that fintech-based financial inclusion (FinFI) affects the high-risk behaviors of MFIs in Sub-Saharan Africa. Consequently, a novel index was developed to measure FinFI, and its impact on reducing the risk appetite of MFIs was empirically investigated using the index. Using several robustness tests, it was determined that the results were legitimate.

Bharti et al. (2021). A study assessing the efficiency of MFIs based on social performance employed Data Envelopment Analysis. MFIs of different sizes (large, medium, small) were evaluated using the Gutman Scale to quantify social output. Results indicated improved performance across MFIs when considering social consequences, despite a focus on rural regions and women clientele. The study suggests that prioritizing social impact enhances overall effectiveness, aiding MFIs in refining their mission and vision statements to achieve financial independence while staying true to their purpose.

Bongomin et al. (2021). A study assessed the predictive power of financial intermediation elements like market access and service quality, drawing on previous research. Using a cross-sectional approach, data was collected from 400 rural Ugandan households. Results showed that 22% of financial inclusion variance could be attributed to financial service availability and quality. Published in the Financial Inclusion journal, the study also analyzed impoverished perspectives on financial inclusion through intermediaries using ANOVA.

Manzoor (2021) <A investigated the concept of microfinance, microfinance firms, and the impact that these organizations have on the financial inclusion process. Offering unfettered and affordably priced access to financial services is a strategy for financial inclusion, which aims to guarantee that these services are provided to those in need in an efficient and successful way. MFIs are crucial for promoting financial inclusion and driving socioeconomic development. Credit was made available to residents in rural and economically underprivileged regions as part of the financial inclusion plan, which was a crucial element of the whole approach. The inquiry's results included suggestions for the expansion and sustainability of microfinance service providers in order to attain higher levels of financial inclusion.

Nair and Jain (2021). The study seeks to connect government entities with rural populations using banking facilities and identifies challenges faced by banks in promoting financial inclusion in rural areas. Through a descriptive survey and structured interviews with rural bank branch managers, the study suggests utilizing Bank Mitras as intermediaries to extend banking services to rural customers. However, concerns arise over the growing dependence on bank employees for digital government payments, highlighting trust issues. The study concludes with recommendations to address these challenges and enhance trust in automated delivery systems for rural financial inclusion.

Njagi and Njoka (2021). The study assesses how microfinance policy influences economic inclusion, particularly when non-deposit-taking MFIs transition to deposit-taking ones. It examines the relationship between MFI board features, regulatory laws, and financial inclusion in Kenya. Using a descriptive research design, it focuses on thirteen MFIs under the Central Bank of Kenya's regulation in 2018, selecting six through purposive sampling. Regression analysis reveals significant correlations between microfinance development, board composition, licensing criteria, prudential rules, and financial service expansion, underscoring their impact on financial inclusion.

Sierra and Rodriguez-Conde (2021). Implemented an internet-based role-play scenario in Uganda's microfinance sector to enhance financial and social inclusion. Higher education institutions serve as catalysts for interdisciplinary, problem-based teaching methods to foster sustainable development. Post-simulation data analysis reveals effectiveness in promoting essential learning outcomes. This interactive approach equips students with competencies in economics, business, and management, emphasizing sustainability. It facilitates understanding of microfinance complexities and its role in alleviating poverty and injustice.

Abel (2020) explored the effectiveness of MFIs in improving financial accessibility for underprivileged individuals in Burundi. Logistic regression analysis revealed their significant role in overcoming barriers to financial inclusion and expanding formal financial services availability for diverse groups. Microfinance also facilitates formal financial service usage among low-income populations in semi-urban areas. It's viewed as a catalyst for socio-economic advancement rather than a sole solution for poverty eradication, enabling gradual involvement in community development initiatives.

3. Research Methodology

3.1 Problem Statement

Microfinance in India has shown promise in uplifting impoverished rural residents, offering loans and other financial services. However, financial inclusion remains a critical issue, especially in rural areas like Karnataka, where many lack access to formal banking. Challenges include limited financial literacy, inadequate infrastructure, gender disparities, and regulatory hurdles. Efforts to enhance financial inclusion must address these challenges to ensure widespread access to banking and financial opportunities, ultimately promoting economic empowerment and poverty reduction.

3.2 Objectives of the Study

- To analyze the role of financial institutions and Banks, in the conversion of unbanked regions to banked regions.
- Evaluating different methods of financial inclusion in Raichur bidar and Chamarajanagar district.
- To examine the contribution of microfinance to solving household problems and promote women's empowerment.
- To examine the role and responsibilities of SHG in financial inclusion.
- To measure the impact of the SHGs (Self-help groups) on the economic development of the members in Raichur, Bidar and Chamarajanagar district

3.3 Significance of the Study

The proposed study on MFIs' role in promoting financial inclusion in Raichur, Bidar, and Chamarajanagar holds significance due to their unique characteristics. It aims to assess MFIs' impact, identify challenges, and offer insights for tailored microfinance strategies. Findings will inform policymakers for better support, identify replicable models, and explore social impacts beyond economic indicators, emphasizing community involvement.

3.4 Scope of the Study

This study examines MFIs' role in fostering financial inclusion in Raichur, Bidar, and Chamarajanagar districts of Karnataka. It analyses geographic, demographic, and socioeconomic factors to understand MFI impact. Key indicators like access to banking, credit availability, and digital financial service usage will be assessed quantitatively. The research also investigates socioeconomic impacts and identifies barriers, aiming to offer policy insights for enhancing microfinance effectiveness in promoting financial inclusion in these districts and beyond.

3.5. Sources of Data

3.5.1. Primary Data-

To comprehensively examine the role of MFIs in fostering financial inclusion in Raichur, Bidar, and Chamarajanagar, a combination of primary data sources has been employed. Surveys and questionnaires have been administered to individuals and households in these regions, yielding direct insights into their experiences with microfinance services and the level of financial inclusion.

3.5.2. Secondary Data

The secondary data has been collected from various websites, magazines, journals, theses and Books.

Shaping financial inclusion policies and programs to address this in the Indian context:

a) **Customized programs for women:** As women displayed a higher willingness for financial inclusion, there is merit in designing suitable products like women-centric savings accounts, loans, and insurance plans. Local SHGs can educate women on financial planning, facilitate bank linkages through proper documentation, digital literacy for managing accounts, and grievance redressal. This can boost saving and borrowing rates among women.

b) **Leveraging youth interest**: Young adults being receptive to financial inclusion makes a case for greater financial literacy programs in schools and colleges. Digital modes can make financial concepts interactive for better engagement. Tie-ups with fintech companies can offer specialized youth accounts, personalized investment advisory, peer interface apps, etc., to capitalize on the tech savviness of young India.

c) **Area-specific programs:** Survey regions showing acute exclusion like tribes, remote villages, and migrant clusters should be mapped. Custom delivery models using local language interfaces, EMI collection tie-ups with farm traders, mobile bank units, on-site enrollment, etc., can overcome accessibility barriers (Gulabsing and Rani, 2022).

d) **Linking self-help groups:** Community structures like SHGs and local cooperatives with regular contact and proximity to excluded groups can be leveraged. Lead bank initiatives can onboard them through appropriate KYC, low-cost products for small deposits/credit requirements, and financial counseling with simple messaging.

e) **Incentivizing business accounts**: Higher income groups showed greater positivity for accessing financial services. MSME promotional schemes with subsidized business loans, tax benefits for new ventures, and cashless merchant platforms can incentivize small business owners to open current accounts. It can boost financial independence along with entrepreneurship at the grassroots (Nalini, Rani and CBVKP, 2023).

f) **Monitoring last-mile outreach through BC model**: India's business correspondent(BC) approach uses banking agents as intermediaries for expanding rural coverage. However, monitoring effectiveness across remote locations with basic infrastructure remains challenging. Robust MIS dashboards, streamlining Aadhaar integration, and encouraging women BC agents for better community connections, can strengthen last-mile connectivity (Gulabsing and Rani, 2022).

In addition, centralized reforms like cleaner lending norms, credit enhancement structures, and seamless account portability between banks and with the postal system, can enrich customer experience. Over time, this can positively influence behavioral biases or misconceptions deterring adoption among the unbanked. Sustained financial literacy campaigns are integral to empowering the poor on financial planning, indebtedness risks, and grievance channels. A collaborative approach between policy bodies, regulatory agencies, banks, and community institutions can amplify financial inclusion in the unique Indian landscape (Rani, 2021).

4. Analysis of Raichur, Bidar and Chamarajanagar Economic Performance promoted by MFIs and Banks through SHGs and on Social Change

4.1. Social Change

4.1.1. District-wise comparisons

Raichur and Bidar: These districts have similar patterns across most indicators, suggesting a consistent impact of SHGs.

Chamarajanagar: This district shows a mixed picture. While it has the highest impact on quality of life and personality development, it lags in other areas like family acceptance and independence.

4.2. Economic Change

4.2.1. District-wise comparisons

a) **Raichur and Bidar**: These districts have similar positive responses across most indicators, suggesting consistent social change through SHGs.
b) **Chamarajanagar**: This district shows mixed results. While they report improvement in some areas like financial contribution and self-reliance, they lag in aspects like family respect and living conditions. This requires further investigation into possible causes.

4.3. Health Change

4.3.1. District-wise comparisons

a) **Raichur**: This district stands out with the highest improvements in most indicators, suggesting a strong impact of SHGs on health awareness and access to necessities.
b) **Bidar**: This district shows moderate improvements across most indicators, indicating a positive but less pronounced impact of SHGs compared to Raichur.

c) **Chamarajanagar:** This district shows similar improvement to Bidar in some areas like family planning but lags in others like overcoming malnutrition. Further investigation into the reasons behind these variations is crunch.

4. Conclusion

Financial inclusion, which refers to the process of integrating the rural population into the formal financial system, is regarded as a crucial roadmap that aims to bring individuals from the unbanked and unreached segments of society into the financial mainstream. The Government of India has undertaken various measures to enhance the status of financial inclusion within the country. However, it is imperative to thoroughly consider the rural areas across all districts and states, as they play a significant role in this process. Consequently, both the Government and the relevant banking authorities should closely monitor these rural regions to expedite the provision of financial services to the rural poor, ensuring that they have access to banking services and products at an affordable cost. The transformation of the Indian banking landscape, transitioning from serving specific classes to catering to the masses, is a groundbreaking initiative implemented by the government and regulators, as it aims to include the population that was previously excluded from the formal financial system. To achieve the objective of empowering marginalized segments economically, it is crucial to integrate financial inclusion and financial literacy, as this will enable individuals to fully leverage the benefits of financial access and enhance their usage of financial services. The national mission to attain inclusive growth with financial stability is a critical component that cannot be achieved without the active and well-coordinated participation of all stakeholders involved in the policy's implementation. Drawing from the experiences of developed economies, it is plausible to accept the proposition that financial inclusion drives economic growth. Thus, every effort must be made to address any obstacles in the implementation process and expedite the progress to prioritize inclusive growth. Financial inclusion must be perceived as a step beyond mere banking inclusion. In conclusion, India must embark on a more assertive and well-planned journey towards financial inclusion to establish itself as a prominent global player in this domain.

Conflict of Interest Statement

The authors of this study declare that there are no conflicts of interest related to this research. The study was conducted impartially and without any influence from external parties or stakeholders. The findings and recommendations presented are based solely on the data collected and the analysis performed. The authors have no financial, personal, or professional affiliations that could be perceived as influencing the research outcomes or interpretations. The study was funded independently, and all procedures were followed to ensure transparency and objectivity throughout the research process.

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