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# Role of Microfinance in Economic Development and Impact on Different Communities

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**Abstract:**

*Microfinance is often defined as financial services for poor and low income clients, including consumers and the self- employed, who traditionally lack access to banking and related services. The basic principles of micro credit is to give poor people access to capital and exploit their capacities and potentialities for economic development. The present study overhauls the role of micro finance and economic growth and its impact. Microfinance is at a booming stage with a great potential for growth. Now this sector has begun to grown, and challenges must be addressed to make this growth effective and sustainable. Therefore, this study contributes to transforming rural India into an engine of economic growth and impact on different communities.*

**Key words**: Microfinance, Micro-credit, Rural India, Economic Development, Communities

## Introduction:

"Microfinance" is often defined as financial services for poor and low-income clients. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as micro finance institutions (MFIs).

These institutions commonly tend to use new methods developed over the last 30 years to deliver very small loans to unsalaried borrowers, taking little or no collateral interest. These methods include group lending and liability, pre-loan saving requirements, gradually increasing loan sizes and an implicit guarantee of ready access to future loans, if present loans are repaid fully and promptly. The two main mechanisms for the delivery of financial services to such clients are:

- Relationship-based banking for individual entrepreneurs and small business;
- Group based models, where several entrepreneurs come together to apply for loans and other services as a group.

Microfinance is a movement whose object is a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance and fund transfers. Many of those who promote microfinance generally believe that such access will help poor people out of poverty, including participants in the microcredit summit campaign. Microfinance is a way to promote economic development, employment and growth through the support of micro entrepreneurs and small business. Microfinance is a broad category of services, which includes microcredit. Microcredit is the provision of credit services to poor clients.

## Objectives of the study

- Able to understand the socioeconomic attributes of households that participate in the Joint Liability Lending microfinance programs;
- Able to understand what determines household decisions for the loan sizes that they acquire;
- To analyse the impact of microfinance on household income;
- To investigate microfinance programs significantly

reduces household to poverty.

## Basic Features of Microfinance:

- Loans are given without security and collateral.
- Loans to those people who live BPL.
- Members of self-help group can also enjoy Micro finance.
- Limit of loan under micro finance is Rs. 25,000.
- The term and conditions given to poor people are decided by NGOs.
- Micro Finance is different from Micro credit; under micro credit, small amount of loans are given to the borrower while under micro finance, besides loans, many other financial services are provided, such as savings account insurance etc.

## Initiatives taken by Government

Both central and state Government has taken a plethora of initiative to promote housing and housing finance in the country. Some of the key schemes being implemented by the Government of India summarized from the 2011 report of the working group on rural housing for the 12$^{th}$ five year plan and various central and state Government websites are:

**Indira Awas Yojna:** The objective of scheme is focused on BPL families by providing them cash subsidy to build low cost houses. Funding is jointly provided by the central and state government in the ratio of 75:25. Launched in 1998-99, the scheme intends to build 2 million additional houses subdivided into 1.3 million in rural areas and 0.7 million in urban areas.

**Golden Jubilee Rural Housing Finance Scheme (GJRHFS):** The objective of this scheme is to improve access to housing finance in rural areas. During 1997-2012, a total of 35 million housing units were financed by HFCs and cooperative sector institutions achieving 94% of the targeted 37.3million units. The scheme has been instrumental in providing increased access to institutional credit in rural areas at the Pan-India level.

**Bharat Nirman:** This programme was launched in 2005 with the visions of accelerating infrastructure development in rural areas. The scheme has been a success so far with 7.2 million houses constructed in the first phase e.g. (2005-09) against a target of 6 million units. The scheme has been extended till 2014 with 12mn additional houses targeted to be built during 2009-14. The second phase is also progressing well with 9.5 million houses already built till date. 2012.

**The national urban housing and Habitat policy 2007**: This policy aims to achieve affordable housing for all by promoting public – private partnerships.

**Affordable housing partnership**: This scheme, introduced by the Government of India, envisages construction of 1 million houses for the economically weaker and low income households with total outlay of Rs. 5 billion.

**Jawaharlal Nehru National Urban Renewal Mission**: JNNURM was launched in December 2005 with the objective of improving infrastructure facilities in urban areas across the country. The program has been launched in 63 cities and includes construction of houses in rural areas.

**Rajiv Awas Yojna (RAY)**: This scheme has introduced basic housing facilities to the urban poor and provides founding assistance to states for implementing slum re-development and affordable housing projects. During the 12th five-year plan period, the scheme is expected to be rolled over 250 cities.

## Types of Informal Credit in India

**Chit Funds**: These are indigenous rotating savings and credit organizations. While chit funds are prevalent among households and small businesses all over India, chit funds are also organized by Chit Fund Firms, normally in South India, and are regulated by the Chit Fund Act.

**Finance Corporations**: These institutions have activities essentially similar to commercial banks, except for non-issuance of cheques and no provision for fund transfer services.

**Hire Purchase Firms**: Such firms are generally active in vehicle and durable finance, specializing in market segments not served by commercial banks. Most of such firms accept deposits from the public.

**Nidhis**: These are single branch institutions similar to credit unions. They are mainly found in South India.

**Wholesalers and other Intermediaries**: Such agents typically combine sale of goods with trade credit. The volume of finance is large relative to the total size of credit markets.

**Commission & Aratias Agents**: They act as intermediaries between local and outstation sales in many commodity markets and provide financial accommodation to their clients. Their main role however is in reducing information costs of both buyers and sellers.

**Angadias**: They play an important complementary role in facilitating fund flows between different centres at costs much below that of banks.

**Indigenous Bankers or Shroffs**: These age old Indian institutions serve businesses, usually trade. They are grouped into various types, along community lines and operate in different parts of India. Among the major groups, chettiars in the south have almost disappeared.

**Brokers**: There is a bewildering array of brokers in informal markets whose main and sometimes only role is informational. They link up potential borrowers and lenders for various purposes.

**Pawn Brokers**: Found mainly in the South, they accept deposits and provide pawn finance. Estimates put the total volume of loans between Rs. 2.5 - 3 billion in 1979.

## Micro-Finance in Indian Context

In India it started from 1950s and till today it mirrors the patterns observed worldwide. Increasing access to credit for the poor and the downtrodden has always remained at the core of Indian Planning for fighting against poverty. The hypothesis behind the expanding outreach of financial services, mainly credit, was the welfare costs of exclusion from the banking sector, especially in the case of the rural poor.

The problems at the start of 1990's looked twofold: the institutional structure was neither profitable in rural lending nor serving the needs of the poorest. Micro credit emergence in India has to be seen in this backdrop for a better appreciation of current paradigm. Successful microfinance initiatives across the world especially in Asia and in India by NGOs provide impetus in it. At this juncture NABARD discovered alternative modules of touching the rural poor and brought the existence of informal groups to the fore. It was realised that the poor tended to come together in a variety of informal ways. The concept of Self Help Groups (SHGs) came into existence by social development NGOs in 1980s.

## Micro-finance and its impact on Development

Micro-finance plays a very significant role in the development of any poor country and in the case of poor people. It helps very poor households to meet their basic needs and protect against the risks, associated with improvements in household economic welfare; it helps to empower women and support women's economic participation, therefore promoting gender equity.

Micro-finance creates access to productive capital for the poor, which, together with human capital, addressed through education and training and social capital achieved through local organisation building, enables people to move out of poverty. The aim of microfinance is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor who are continuously ignored by the formal banking sector.

## Microfinance- Impact on poverty

Micro finance plays a pivotal role in poverty elimination as far as the impact assessment is concerned. Microfinance governance is necessary not just to show to donors that their interventions are having positive impact but to allow for learning within MFIs so that they can improve their services and the impact of their projects. Poverty more than just a lack of income highlights the shortcoming of focusing solely on increased income, as a measure of the impact of microfinance on poverty. It depends what the poor do with money, often it is gambled away or spent on alcohol, so focusing solely on increasing income is not enough. The focus needs to be on helping the poor to sustain a specified level of well-being by offering them a variety of financial services tailored to their needs so that their net wealth and income security can be improved. The projects in India, Indonesia, Zimbabwe, Bangladesh and Uganda reflect a very positive impact of microfinance in reducing poverty. In India for the last three quarters it has been observed that clients saw significant improvements in their economic well-being and that half of the clients broke the vicious circle of poverty.

## Impact on Household Sector

Health and education are the key areas of non-financial impact of microfinance of households. The impact of microfinance interventions on health and education, nutritional indicators, seem to improve where MFIs have been working. Microfinance interventions have also been shown to have a positive impact on the education of clients' children. **Littlefield** and **Hashemite** state that one of the first things that poor people do with the income from microenterprises activities is to invest in their children's education. Studies shows that children of microfinance clients are more likely to go to school and stay longer in schools.

## Empowering Women

The main role of micro finance is to empower women. In India and other Asian countries, self employment through microfinance was perceived as a powerful instrument for the emancipation of women. MFIs can't empower women directly but can help them through training and awareness to raise to challenges of the existing norms, cultures and values which place them at disadvantage in relation to men and help them have greater control over resources and their lives.

## Indicators of women empowerment through microfinance

- Ability to save and access loans in easy way
- Opportunity to undertake an economic activity
- Mobility opportunity to visit nearby towns
- Understand the MFIs procedure and banking transactions
- Development of skill of income generation
- Decision making within household
- Group mobilisation
- Role in community development.

## Conclusion

This study is attempted to understand the scale and spread of micro finance as an important tool of financial inclusion in India using secondary level data.

Following are the major concluding observations from the exercise based on secondary data. Studies show that microfinance has resulted in improved health care, children's education and nutrition and women's empowerment. In particular, the ability to borrow, save and earn income is the role of MFIs in development specifically in relation to alleviating poverty. There have also been examined key challenges facing MFIs today that are affecting their impact on poverty alleviation: an over-emphasis on financial sustainability over social objectives and failure of many MFIs to work with the poorest in society. However, when implemented and managed carefully and when services are designed to meet the needs of lines, micro finance has positive impacts, not just on clients, but on their families and on the wider communities. Micro finance expansion has remained a minuscule of bank credit in India.

In 2007, that is a decade and half since it is in option in the form of SHG-bank linkage program, credit to SHGs constituted less than one percent of the total bank credit from schedule commercial banks. Secondly, the data available for the last five years show that there has been a falling travel in the percentage share of bank credit to and loan accounts held by SHGs. Thirdly, there has been considerable regional disparity in terms of the spread of micro finance in India. The southern region of India is way ahead of the other regions not just in terms of the absolute number of SHGs formed and the bank credit supplied to these SHGs but also in terms its coverage of poor persons residing in this region. A comparison with the number of poor persons is useful as micro finance is essentially a means of providing bank credit to the poor sections of the population.

Given that the southern region has been historically one of the well-developed regions in terms of banking infrastructure, this concentration of Micro finance undoubtedly adds to regional disparity.

Fourthly, as micro finance is primarily driven towards women, the coverage of women under the existing banking network can also be an indication of the spread of micro finance. Though there are about 93 women per 100 men in India, there were only 21 loan accounts per 10,000 women as compared to 118 loan accounts per 10,000 men in the country. Further, on an average, the amount of bank credit outstanding per women worked out to Rs. 20 for Rs. 100 outstanding per man. This disparity in terms of deposits was little less but it still reflects the wide gap related to the financial inclusion of women vis- a- vis men.

To conclude, the findings of the study reflect the significantly limited scale and spread of micro finance in India.

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