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Micro-Finance and its Impact on Rural & Economic Development

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Abstract

Micro finance has been positioned one of best tool for Poverty Cut and Social Development in the growing economies. Poverty is the major factor that becomes the hindrance in achieving the advanced growth in these developing countries. The study is sought to establish whether microfinance empowers the economic development or not. As India is growing economy with more than 1.2 billion population. There are many challenges and opportunities being felt in the way of Microfinance with the span of time. In the latest years microfinance is in reports for shocking reasons. Various suicide cases had taken place by micro credit clients all over the India for excess interest charges and high handedness of recovery of loans. The paper discusses the factors and theoretical position associated with evolution of microfinance and its role in global scenario. From past few decades Microfinance sector has gained comprehensive progress and transform many people beyond poverty line in India. Micro finance plays vital role to generate employment and income opportunities by offering small loans to lower income group people. Thus it has been consider as a significant instrument for economic development. In India, huge population belongs to rural areas and with the extraordinary advancement of microfinance tools there are brilliant changes occurring in the economy. This paper discusses the impact of microfinance in the rural and economic development.

Key words: Micro Finance, SHGs, Micro Credit, Economic Development.

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Introduction

Microfinance is an economic development tool, it is not just about giving micro credit to the poor. Its main purpose is to support poor to work their way out of poverty. It includes a wide range of services like Loans, microcredit, Insurance, savings, remittance and also non-financial services like guidance, counselling etc.

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Microfinance has existed, although mostly in the shadows and unseen by casual observers, since the increase of formal money systems which most likely predates them. But from the previous four decades, serious global efforts have been created to sanctify the monetary service prerequisite to the needy people. The Micro finance process began in early to mid-1980s and it has since gathered a formidable momentum. These days there are ample of MFIs providing financial services to an estimated 100 - 200 million of the world's poor (Christen et al., (1995)). The significance of microfinance in the field of development was reinforced by the initiation of the Microcredit Summit in 1997. The main objective of this summit to reach the Poor families, with credit for self employed & other financial services especially women till 2015. (Microcredit Summit, 2005).

The success of micro finance convinced the financial investors that the timely investments in microfinance realised a very healthy profits. Also the rich individuals liked the idea that by passing their accumulated wealth to the microfinance sector, they can serve an act of humanity.

Review of literature

Mayoux (2001) explains the contribution of micro finance to increasing incomes of the poor and also women. He also stated that it also enabling the poor to cope with unpredictable shocks and emergencies.

NABARD conducted a study (2002) which shows the result that there has been positive change in standard of living of SHG's member in terms of savings, borrowing capacity, and income generated manners. There is drastic change in the housing conditions of the people of small income. The trend of consumption loans has also been changed; purpose of loan is income generation.

Benjamin, L., J. S. Rubin, et al. (2004) describes in their paper that CDFIs (Community development financial institutions) facilitate primarily the financial needs of the low income group. It contains venture capital funds, credit unions, banks, and microenterprise loan funds, although the success of CDFIs in economic development area, they didn't get impartial interest from various academic researchers.

Deventer, P. And A. Huybrechts (2005) A comparative overview of the most relevant

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findings from studies the impact of Micro-Credit institutions like the Grameen Bank and BRAC in Bangladesh. It first evaluate the facts on economic impacts, which suggests that the susceptibility of bank members has been reduced even if there is no consensus about whether the two institutions also reduce poverty.

McIntosh, C. A. de Janvry, (2005) The data from Uganda's largest incumbent Micro-Finance institution to analyze the impact of entry by competing lenders on user behaviour. In their study it is observe that increasing competition does not show an increase in client withdraw rate, but it induces a decrease in repayment performance and savings deposited with the incumbent, signifying growing multiple loan-taking by clients.

Ananta Basudev Sahu and Sandhya Rani Das (2007) concluded that SHGs have served the source of women empowerment.

Hans (2008) analyzed that timely available credit at affordable cost act as one of the vital inputs for economic development in long run. In his study he reveals that the level of exclusion from credit markets is much more, 13% of the adult population included in number of loan accounts. The credit coverage ratio is 25 % in southern region as low as 7.7 and 9 percent respectively in North Eastern and Central Regions.

Dalla Pellegrina (2010) finds in her study that microfinance may be less beneficial to building up fixed assets because it is having lending characteristics like short and regular repayment schedules and the group lending method. Borrowers generally caught the attention of short term revenue investment projects.

Becchetti and Castriota (2010) study the impact of microfinance by focusing on its effectiveness as a recovery tool after a natural tragedy. In their paper they conclude the involvement of microfinance credits in helping the victims of Tsunami in Sri Lanka 2004. Their study thus finds strong evidence that microfinance is an effective tool.

Objectives of the Study

1. To learn the impact of Micro finance on rural development in India.
2. To find out various challenges faced by Micro Finance.
3. To study the various success factors of Micro Finance in India

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Research Methodology

The study is descriptive in nature. The research is based on secondary data. Various Magazines, news papers, research articles, journals, and books have been studied to obtain the objectives of the research.

Impact of Micro Finance

In the Indian framework, Micro finance is the innovation in the traditional methods which people use to meet their financial needs or to improve their standard of living. According to facts and figures about 2.5 billion people are living in poverty around the world. And in India there are approximately 32 % of the total populations seeking opportunity to ensure their income security and create assets. The impact of Microfinance has been shown with a variety of viewpoints:

Micro Finance and Rural Development: In the past few decades micro finance has been growing rapidly. It was National Bank for Agriculture and Rural development (NABARD) which was conventional in 1982, had taken the initiative of micro finance and became first organization to bring this concept to enhance the rural development and agriculture activities in India. Successful Micro-Finance interventions across the world especially in Asia and in parts of India by NGO have provided further momentum. In this milieu, NABARD is searching for other models to reach the rural poor and brought the existence of informal groups of poor to the fore. It was realized that the poor tended to come together in a variety of informal ways for pooling their savings and dispensing small and unsecured loans at varying costs to group members on the basis of requirement. Social development NGOs discovered the concept of self help group in 1980. Realizing that the only constraining factor in unleashing the potential of these groups was meagerness of their financial resources, NABARD gave the idea to link these groups with banks, so that the problems related to financial constraints can be overcome.

Micro Finance and Financial Inclusion: Microfinance has been acknowledged as vital tool in connectivity the unbanked population to mainstream institutional banking services. It helped to reduce borrower's dependency on local money lenders or other non institutional sources. Financial Inclusion started in Nov 2005 when RBI engaged the banks to open

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Accounts with Zero minimal balances. These accounts were used later on by government to make payments to people for their welfare like pensions, cash subsidy, social security benefits etc.

However, Skoch development foundation in its study declared that "No Frills Accounts" are opened only in between April 2007 and March 2009. And among them only 11% is operational. Dr. Rangarajan (who headed the financial Inclusion Committee in 2006) recommended that to meet the development & promotional costs of financial inclusion, "Financial Inclusion Fund" (Budget 2007-2008 – Financial Inclusion) was established, and to support the process of financial inclusion, "Financial Inclusion Technology Fund" (Budget 2007-2008 – Financial Inclusion) was established. These funds with an amount Rs. 500 crore each were operated by NABARD.

The RBI had asked all the public and private sectors banks to submit their financial inclusion plans (FIPs), which had been rolled out in three years from Apr 2010 –March 2013. RBI took the initiative to take maximum financial inclusion with the help of several schemes like:

- ✓ Opening No Frills Accounts
- ✓ Relaxation of Know Your Customers norms
- ✓ Deployment of Business Correspondents (BCs)
- ✓ Opening branches in the rural centers
- ✓ Adoption of Electronic Benefit Transfer (EBT)

There are lengthened ways to go for the financial inclusion to reach successfully to the core poor people. As per K.C. Chakrabarty Deputy Governor of RBI "Even these days the very fact remains that just about 1/2 the Indian population doesn't have access to formal monetary services, they just depend on money lenders. Whereas formal monetary establishments should gain the trust and goodwill of the poor through developing sturdy linkages with community-based financial ventures and cooperative. Financial Inclusion has not got the specified results and there's long road ahead however little question it's enjoying a major role and is functioning on the positive aspect.

Micro Finance and Self Help Groups:

It was Md. Yunus who had found the origin of SHGs (Small Help Groups) from the brain child of Gramin Bank of Bangladesh in 1975. In India there are SHGs and Gramin Banks are two common approaches of Micro Finance. It is an informal group of 10-20 members having

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same social background, and having motto "Savings First and Credit afterward". (Samarpreet,2010). The people/group of people who are usually not expecting to have Savings, Small Help Groups mobilize their savings. They recycled their savings effectively. Also they pool the savings among the members SHGs have been able to mobilize savings from persons or groups who were not usually expected to have any 'saving' and also to recycle effectively the pooled resources among the members, and this mechanism is used to meet the needs of the poor. SHGs also intended to be the instrument of empowerment of society specially women.

Micro Finance and Poverty Reduction: In India one fourth of its total population is under the poverty line. According to the reports of World Bank around 390 million people in India live below the standard of living. The maximum poor people are in the three states Madhya Pradesh, Uttar Pradesh and Bihar. Microfinance has proved to be the major policy tool for purge the poverty. People lend large loans in small numbers so that admin cost can be minimized. Micro finance encourages the poor people to take the initiative to bring together their incomes and assets to maintain the economic safety. It is great experience of Micro Finance to provide loans to small entrepreneurs; they pay back their loans timely and use their incomes/profits to generate their financial security. It is the best option instead of borrowing the money from informal lenders.

Micro Finance and Women Empowerment: In India many macroeconomics policies has been failed to resolve the problem of Gender inequality. As women is the indivisible part of society. The active participation of women is very less in the economic activities. There are many barriers like lack of education, poverty etc. Micro Finance deals with the women below poverty line. Women are the best customers and best managers of resources than men, If loans are routed through women benefits of loans are spread wider among the household. Women empowerment is the key factor in eradicating the poverty among society, as women plays as protagonist in economic development. SHGs have been known as one proficient source of empowering women.

Micro Finance & its success factors: from the last few years' micro finance provide funds timely with lower interest rates to small entrepreneurs and other needy people and upgrade the society. Because previously they lend funds from the informal lenders on a very high

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interest rates than the market, as it was the only & easy alternative for them. But presently micro loans are the lucrative alternative for borrowers with the commencements of NGOs, Community Banks, & MFIs. And also it is providing the poverty reducing tool. Due to the low cost of operations and economic attractiveness or sustainability micro finance attract many lending agencies.

Critical Issues face by Micro Finance Institutions in India:

Micro Finance provides better services as compared to conventional banking methods. It also joins with lending & borrowing money in rural areas and accomplishes the requirement of rural people also and especially women who want to run the business to run her family's expenses. But with the success of Micro Finance activities there are some critical issues for Micro Finance Institutions which are:

SUSTAINABILITY

The first issue is the sustainability. In the literature, it is reported that MFI model is ccomparatively costlier in terms of delivery of financial services. Jindal & Sharma in his paper shows that 36 leading MFIs 89% MFIs sample were subsidy dependent and only 9 were able to cover more than 80% of their costs. It is the fact that the cost of supervision of credit is very high whereas the loan volumes and size is low. It is also said that the interest insensitive clients of small loans, MFIs levy higher cost of credit. Therefore MFIs should formulate some strategies for enhancing the range and volume of their financial services.

Capacity of MFIs

The sustainability of MFIs and their clients go together, also it is accepted that Micro finance has both communal and marketable magnitude. It follows to building up of capacities of the MFIs and their primary stakeholders. Innovations are very important for social intermediation & strategic linkage. Therefore new approaches which are more focused on the liveliness issues of poor has been come forward, and reengineered Financial Products are offered to them.

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Lack of Capital

Many of MFIs are having high debt equity ratio, because these are social oriented and don't have adequate access on financial capital. Presently there is no any adequate mechanism to accomplish the equity capital requirement for MFIs in India.

Conclusion

The purpose of Micro Finance is to make available the umbrella of financial services to the meagre people so that they can enrich their social status. It helped a lot to bring many rural and poor people above the poverty line. Micro Finance can contribute into solving the problems like insufficient housing in rural area, poverty alleviation, empower women etc. it helps to enhance the development of country very slickly. Eventually it is leaving a gigantic societal & economic impact. Micro finance institutions also contribute by improving the creditworthiness of the poor & also make them more bankable. The paper also studies that Micro Finance Industry can build up more measures against over-indebtedness and adjust the challenges of oversupply. Government can also play an important role in creating a encouraging environment to boom micro finance. This sector exchange a very big hand to serve the society in many ways

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