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# CRITICAL ANALYSIS OF MICRO FINANCE IN INDIA

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## ABSTRACT:

Banking services have always been for those who have money, not for those who have little or no cash income, as history has shown. This necessitated the provision of a broad range of financial services to poor and low-income households, such as deposits, loans, and payment services. In response to this requirement, a new and well-known poverty-fighting technique emerged in recent decades: micro-finance. By definition, a microfinance organisation provides financial services to impoverished entrepreneurs, the most frequent of which are small loans. It also includes providing additional services to the poor, such as savings opportunities and microinsurance. As a result, microfinance began as an attempt to enhance poor people' access to modest deposits and small loans, which had previously been denied by banks.

Keywords: microfinance, banking, financial system

## 1. INTRODUCTION:

The origin of contemporary microfinance is supposed to have occurred in rural Bangladesh in the mid-1970s, when Dr. Muhammad Yunus, in the middle of a famine, established Grameen Bank to promote economic and social development from the bottom up. It quickly spread to hundreds of villages. He disbursed and recovered thousands of loans through a special partnership with rural banks, but the bankers declined to take over the operation at the end of the pilot phase. The Grameen Bank was eventually established in 1983 with the help of donors. Grameen Bank's initial success prompted the development of numerous other microfinance organisations, including BRAC, ASA, and Proshika.

Microfinance in India dates to the early 1970s, when the Gujarat Self Employed Women's Association (SEWA) established the Shri Mahila SEWA Sahakari Bank as an Urban Cooperative Bank with the goal of providing banking services to disadvantaged women working in the unorganised sector in Ahmedabad.

In the face of the formal financial system's apparent inability to meet the financial needs of the rural poor, NABARD made the first major effort to reach out to these people in 1986-87, when it supported and funded an action research project on 'Saving and Credit Management of Self-Help Groups of Mysore Resettlement and Development Authority (MYRADA).

Since independence, the Indian government has placed a strong emphasis on providing financial services to the poor and underprivileged. In 1969, the Indian government nationalised commercial banks and ordered them to lend at a reduced rate to the priority

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sector, which comprised agriculture and other rural businesses, as well as the poorer sections of society in general. Small Farmers Development Scheme (SFDS) 1974-75, Twenty Point Programme (TPP) 1975, National Rural Development Programme (NRDP) 1980, Integrated Rural Development Programme (IRDP) 1980, Rural Landless

Many more programmes include the Employment Guarantee Programme (RLEGP) of 1983, the Jawahar Rozgar Yojna (JRY) of 1989, the Swarna Jayanti Gram Swarojgar Yojana (SGSY) of 1999, and many others. However, due to poor execution and malpractice, most of these programmes failed to meet their objectives. IRDP was thought to be an excellent scheme launched by the Indian government to augment micro-credit operations. It entailed commercial bank's lending less than Rs 15000/- to the socially disadvantaged. Over the course of nearly two decades, a total investment of over $250 billion was made in around 55 million families. However, this supply-side initiative (which ignored the demand side of the economy) fell far short of its intended target. The biggest flaw was the program's design, which included large amounts of subsidies (25-50 percent of each family's project cost), resulting in widespread fraud and misappropriation of funds. As a result, lenders began to consider IRDP loans as a self-serving gift, and they failed to follow up with borrowers. As a result, IRDP estimates of repayment rates ranged from 25 to 33 percent. The IRDP's two decades of poor performance harmed micro-borrowers' creditworthiness in the eyes of bankers and hampered access to banking services for the less literate poor. The programme had a significant long-term impact on the development of micro-entrepreneurship among society's underprivileged. As a result of poor execution and political intervention, "The world's largest microfinance programme" failed. The Planning Commission set up a committee in 1997 to assess the efficacy of wage employment and self-employment programmes. The committee proposed that all self-employment schemes be merged, as well as a shift in emphasis from individual beneficiaries to a group-based approach. It also stressed the importance of identifying activity clusters in certain locations, as well as effective training and marketing tactics. The proposals were adopted by the Indian government, and on April 1, 1999, the Swarnajyanti Gram Swarojgar Yojana (SGSY) was inaugurated. This programme was created by combining IRDP and several allied programmes such as TRYSEM (Training of Rural Youth for Self-Employment), DWCRA (Development of Women and Children in Rural Areas), SITRA (Supply of Improved Toolkits to Rural Artisans), GKY (Ganga Alyan Yojana), and MWS (Maharashtra Women's Welfare Scheme) (Million Wells Scheme). This is a comprehensive programme that addresses all areas of self-employment, including the development of self-help groups (SHGs), training, credit, technology, infrastructure, and marketing. The program's goal is to create many microbusinesses in rural areas. It's a credit-cumulative subsidy programme that focuses on activity clusters. Beneficiaries have responded enthusiastically to this scheme.

## 2. CONCEPT OF MICROFINANCE:

Microfinance activities provide a wide range of financial services to persons who lack traditional collateral or none. It assists individuals in accumulating assets, surviving crises, and establishing small businesses to escape poverty. This innovative programme reaches out to the disadvantaged, particularly women, and has a positive impact on their socioeconomic

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development and empowerment. By offering small-scale savings, credit, insurance, and other financial services to poor and low-income households in India, microfinance has aided rural development, women empowerment, and wealth generation. Microfinance programmes, in addition to extending small loans (Micro-credit), provide a variety of other financial and non-financial services, such as savings, insurance, guidance, skill development training, capacity building, and motivation to begin income-generating activities to increase credit productivity.

**2.1 Micro-finance and Micro-credit**

The terms micro-finance and micro-credit are sometimes used interchangeably. Micro-finance, often known as micro-credit or micro-lending, refers to providing modest amounts of working money to the self-employed or self-employed-seeking poor. Micro-credit is defined by Tripathy (2006) as an extension of small loans to be supplied in numerous doses based on the absorption of needy recipients who are too poor to qualify for traditional bank loans because they do not have assets to offer as collateral security for loans. Micro-credit is defined by Nashi (2004) as "credit and recurring credit provided in tiny amounts to meet the needs of the receiver, at a reasonable pace of repayment, and at an appropriate rate of interest." The Micro-credit Summit in Washington, D.C. (February 2007) described micro-credit as "programmes that provide credit for self-employment and other financial and commercial services to very poor people." Even though microcredit and micro-finance have become interchangeable, micro-finance can be regarded in a larger perspective as both micro-credit and micro-savings." When the phrase "micro-finance" is used, it refers to a set of additional services that go along with credit, such as the opportunity to save and the provision of insurance services for assets purchased with micro-credit. Thus, whereas Micro-credit refers to the provision of small-scale loans, the word Micro-finance encompasses a larger range of financial services such as savings, insurance, and so on.

Microfinance is a small-scale financial service (including savings, credit, insurance, business services, and technical assistance) provided to rural people who run small or micro-enterprises, provide services, work for wages or commission, and other individuals and groups working at the local level (Samapti Guha and Gautam Gupta, 2005)

**2.2 Defining Micro-finance**

Microfinancing is a relatively new word that is often used to address issues such as poverty reduction, financial support for microentrepreneurs, gender development, and so on." It also serves as an umbrella phrase for providing financial access to those sectors of the population who are not served by conventional financial service providers, through specialised financial intermediaries.

However, there is no legal definition of microfinance. Microfinance is defined by the taskforce on Supportive Policy and Regulatory Framework for Microfinance as "the provision of thrift, credit, and other financial services and products in very small amounts to the poor in rural and semi-urban areas in order to enable them to raise their income levels and improve their living standards." Micro-finance is defined by NABARD as "the provision of small-scale savings (savings), credit, and other financial services and products to the poor in rural, semi-urban, and metropolitan regions in order to enable them to raise their income levels and improve their living standards" (Indira Misra,2003). Micro-finance, in other words,

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relates to the financial needs of individual borrowers to carry out diverse economic activities at the grassroots level.

Micro finance, according to the World Development Report (WDR), is a market-based formal method for mitigating the risks faced by impoverished people, as opposed to informal group-based mechanisms such as saving and credit associations (Tara S.Nair, 2001). The National Credit Fund for Women or the Rashtriya Mahila Kosh, India's most famous national level micro-finance apex agricultural offering micro-finance services for women, describes micro-finance as a collection of services involving the following activities: (a) micro-credit: tiny loans; generally, for income-generating activities, but also for consumption and contingency requirements; (b) micro savings: thrift or small savings from the borrower's own resources (Archana Sinha, 2004).

Microfinance's definition encompasses a wide range of activities, from simple financial arrangements for the needy in various places to various fields of activity in many forms. It not only includes lending, but also includes deposit mobilisation and the supply of life and animal insurance. It refers to "small-scale financial services for both credits and deposits" that are "provided to people who farm, fish, or herd; operate small or micro-enterprises where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draught animals, machinery, and tools; and to other individuals and local groups, in both rural and urban areas, in developing countries" (Robinson, 1998).

Microfinance is thus a limited-quantity financial service supplied to the underprivileged by financial institutions. Savings, credit, insurance, leasing, money transfers, equity transactions, and other financial services may be given to customers to meet their regular financial needs, with the exception that (1) transaction value is minimal and (2) customers are impoverished (Rajaram and Dasgupta 2005).

In essence, microfinance can be defined as an institutional mechanism for providing credit support in small amounts to people with limited resources and skills, usually through small groups, as well as other complementary support in small amounts, such as training and other related services, to enable them to engage in economic activities. 'Micro enterprises is the heart of development because micro enterprise programmes work - they raise women and families out of poverty,' stated US first lady Hillary Clinton at the November 1995 Micro Summit. It's called micro, but its impact on people is massive: we've seen how a few dollars, frequently as little as ten dollars, can enable a woman obtain self-employment and raise her and her family out of poverty. It is a helpful hand, not a handout.' (Archana Gupta and Lekshmi R. Kulshreshta, 2005).

Micro-finance thus refers to the complete range of financial and non-financial services provided to the poor, including skill upgradation and entrepreneurship development, in order to help them overcome poverty, with a focus on women's empowerment. Microfinance's operational framework is based on the assumptions that: (a) forming a self-employment enterprise is a viable alternative to alleviating poverty; (b) lack of access to capital assets/credit is a constraint on existing and potential micro-enterprises; and (c) the poor can save despite their low-income level.

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## 2.3 MODELS OF MICRO-FINANCE

The following are the delivery models of micro-finance adopted around the world-

1. **GRAMEEN BANK MODEL** It is one of the most well-known and effective microfinance models. Bangladesh is the originator of this approach. Participants are divided into groups of five and are required to contribute to a group savings and insurance fund. Each group member has her own bank account for savings and loans, and after contributing to the savings fund for a set period, the group members receive individual loans from the bank. The group is not required to provide any guarantee for the reimbursement of its members in this situation. The individual borrower is entirely responsible for repayment, and there is no joint obligation, meaning that group members are not liable to pay on behalf of a defaulting member. Loans are available for six months to a year; however, repayments are due on a weekly basis. Bank employees keep individual records of group members and facilitate all financial transactions, making work easier but hindering members' empowerment. The Grameen model has been reproduced in more than 40 countries across Asia, Africa, and Latin America, with local situations and cultures being modified as needed. This concept is used by BancoSol in Bolivia, the Association for Sarva Seva Farms (ASSEFA) in India, and many other solidarity organisations.
2. **JOINT LIABILITY GROUP MODEL-** A Joint Liability Group, consisting of four to ten people, is formed (JLG). Members of the organisation can take out bank loans with a collective guarantee, and there are no requirements for them to have a savings account. Everyone in the group signs a joint responsibility contract, making each other fully accountable for all loans taken out by everyone in the group. As a result, the lending institution simply receives social collateral. These are largely credit groups, and members are not required to save on a regular basis. Most MFIs in India form these types of groups since they are simple to form and have few limits on loan usage. This strategy is being used by NABARD to provide loans to tenant farmers who cultivate land as oral lessees or sharecroppers, as well as small farmers who lack official title to their land holding.
3. **INDIVIDUAL LENDING MODEL**- Individuals can acquire loans without having to be a member of a group in this concept. Financial institutions must maintain frequent and close touch with individual clients to supply credit products tailored to their personal needs. Many financial institutions, like the Dominican Republic's Association for the Development of Micro-Enterprises (ADEMI), Indonesia's Bank Rakyat, Senegal Egypt's Self-Employment Women's Association, India's Self-Employment Women's Association, and others, have adopted the approach.
4. **THE GROUP APPROACH-** Instead of financial institutions, the group model delegated the entire financial process to the group. All financial activities, including as saving, obtaining loans, repaying loans, and maintaining records, are controlled at the group level. This strategy involves forming a group of 10-20 people who save a set amount of money on a regular basis in a common fund. The quantity and frequency of savings are chosen by the members of the club. After a few months of successful operation, the group is linked to a financial institution to obtain credit. The financial institution makes the loan under the group's name, and each member is accountable for repayment. The loan amount is

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determined by the group's total accumulated savings. The conditions for distributing the loan among the group members are decided by the group members themselves. The peer pressure in the group aids in prompt loan payback. As a result of their continued involvement in various group activities, these types of group-based credit delivery help to empower group members. SHG-BLP, or group-based credit-delivery method, is a popular method of providing microfinance in India.

**5. VILLAGE-BANKING MODEL/COMMUNITY BANKING**- This paradigm can be viewed as a development of the group strategy. The Foundation for International Community Assistance (FINCA), a non-profit microfinance organisation in BOLIVIA, established this approach in the mid-1980s. Here, a village bank is formed by bringing together 30 to 100 low-income people who want to improve their life through self-employment. The bank is funded through internal mobilisation of member savings funds and loans from sponsoring MFIs. MFIs provide capital to the bank, which in turn loans to its members. The village bank is administered by its members, who elect its leaders, develop their own bylaws, issue loans to individuals, and collect savings and payments. Loans are repaid in tiny weekly instalments. As a result, village banks have a high level of democratic governance and autonomy. CARE (Cooperative for Assistance and Relief Everywhere) in Guatemala and Burkina Fasco are two MFIs that employ the approach. Bolivia, Mali, Ghana, and other countries.

**6. CREDIT UNIONS AND CO-OPERATIVES-** Credit unions and cooperatives are member-owned businesses that offer credit and other financial services to their customers. Co-operatives are frequently formed by people who share a shared interest or belong to the same local or professional group. Co-operatives typically offer a wide range of banking and financial services to their members. Members vote on all key decisions and elect their officials democratically from among themselves to oversee the co-management. operative's Only members are eligible for loans. Sri Lanka's SANASA Development Bank is an example of a rural credit cooperative that is successfully providing microfinance services.

## 3.CONCLUSION:

Microfinance can be extremely important in delivering financial services to the poor and low-income people in a country like India, where around 70% of the population lives in rural areas and 60% is dependent on agriculture. In a developing nation like India, micro-finance is seen as an effective tool for socioeconomic improvement. It is anticipated to have a big impact on development and reducing poverty.

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