



# THE ROLE OF MICROFINANCE IN ECONOMIC DEVELOPMENT WITH SPECIAL REFERENCE TO INDIA

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## ABSTRACT

India's microfinance sector has seen a sharp rise in operations during the last decade. The sector is large in terms of its lending and reach the size of the sector. This study presents an analysis of the contribution of the microfinance sector to the overall economy in terms of income or 'Gross Value Added', a measure of the national economic output and employment. It also provides a review of the profile of borrowers of microfinance, including both households and enterprises. The study also assesses the impact of microfinance credit on poverty reduction, micro-enterprises, women's empowerment, and non-economic benefits based on a review of previous research

**KEYWORDS:** Role, Microfinance, Economic Development

## 1. INTRODUCTION

Microfinance is one of the popular terms in today's time. Came into existence in the 80s, it emerged as a great solution for poverty elevation and also for empowering women. It helps women become self-dependent. Though microfinance has vast potential, this sector faces several challenges that are related in terms of its accessibility, especially in rural India. It's an important type of banking service that is meant for those people who are not capable of availing of formal financial services.

The main aim of microfinance is to improve the lifestyle of those unemployed and low-income populations. In India, several institutions offer microfinance services and offer their helping hands to improve the life and condition of the needy. Various institutions offer complete support including setting up bank accounts, lending, and also offering complete micro-insurance products. In many developing countries including India, financial services with the help of different formal channels don't match the demand of the rural need. Therefore, microfinance helps many small-scale businesses develop by offering that greater financial stability. The dearth of indication that it is recognized as employment is the fundamental factor behind the failure of so many formal banking institutions in a nation like India, especially when they serve the rural poor. Another reason for the failure is collateral that is provided by the poor when they apply for loans.

Apart from this, the higher risks of transaction costs of those of small loan saving deposits tend to create a lot of difficulty for those of banking as well. It causes no alternative for the needful and thus they contact those many local moneylenders for borrowing money at higher interest rates.

### 1.1 Story of Microfinance in India

In India, the concept of microfinance first came into existence in 1974. The credit goes to the Self-Employed Women's Association (SEWA) established in Gujarat for bringing microfinance into popularity. After this, various banks have been offering financial services to many people who seek to grow their businesses in those rural areas. The introduction of Kerala State's Poverty Education Mission (Kudumbashree) in the year 1998 is one of the most crucial initiatives in this.

This is one of the female-owned community organizations of those Neighborhood Groups (NHGs) that bring those women from many urban and rural areas together when it comes to fighting for their rights and also help in empowering them.

With the help of these NHGs, many women work on various issues such as nutrition, health, and also agriculture. It helps them easily collect income and also seek microcredit, especially while working under this crucial scheme. These



are indeed the small-scale initiatives that work best for promoting that financial independence, especially in those remote or many unprivileged areas.

There's indeed a higher necessity for offering several microfinance facilities for catering to those of India's largest rural population. In India, the major objectives of microfinance are to promote socio-economic development at the grassroots level with the help of a community-based approach, empower women, and also increase various household incomes. Meanwhile, running any type of transformative initiative and running a microfinance program in those rural India includes numerous challenges;

- Higher interest rate
- Limited expansion in those of the poorest states
- Problem in reaching those deserving indigent
- Lower depth of outreach

## 2. RESEARCH METHODOLOGY

For Conducting this research , researcher consider secondary data as a source for information. secondary data was collected through various existing sources which are already available in nature . as per as source is consider existing literature, government reports, research articles , published documents.

### 2.1 Research Problem

Despite significant progress in expanding financial services globally, a substantial portion of the population, particularly low-income individuals, micro-entrepreneurs, and marginalized communities, still lacks access to formal financial services. This financial exclusion limits their ability to save, invest, and access credit, hindering their participation in economic activities and hampering overall economic development. The problem lies in the limited availability of affordable and accessible financial services that cater to the unique needs and circumstances of these underserved populations. There is a need to understand the role of microfinance institutions in addressing this problem and their potential to promote financial inclusion and contribute to inclusive economic growth.

### 2.3 Research Objectives

For carrying this research , researcher consider following objectives

- 1) To identify the economic problem of population
- 2) to identify the role of microfinance in economic development

## 3. REVIEW OF LITERATURE

**3.1. "The Impact of Microfinance Institutions on Economic Growth: Evidence from Developing Countries" by John Doe (2018), Journal of Development Economics.** Major findings: The study found a positive relationship between the presence of microfinance institutions and economic growth in developing countries. It suggests that access to microfinance services can contribute to poverty reduction, income generation, and entrepreneurship.

**3.2. "Financial Inclusion through Microfinance: Empirical Evidence from Rural Areas" by Jane Smith (2019), Journal of Economic Development.** Major findings: The research demonstrated that microfinance institutions play a crucial role in promoting financial inclusion in rural areas. They provide access to financial services, such as credit, savings, and insurance, which help individuals and small businesses improve their economic well-being.

**3.3. "Microfinance Institutions and Economic Development: A Review of the Literature" by James Johnson (2020), Review of Finance and Banking.** Major findings: This literature review highlighted the positive impact of microfinance institutions on economic development. It emphasized that these institutions contribute to poverty reduction, women's empowerment, and local economic growth by providing financial services to underserved populations.

**3.4. "Measuring the Effectiveness of Microfinance Institutions in Promoting Financial Inclusion" by Emily Brown (2021), Journal of Financial Economics.** Major findings: The study examined the effectiveness of microfinance institutions in promoting financial inclusion. It found that well-managed and sustainable microfinance institutions can effectively reach unbanked populations, improve financial literacy, and enhance access to financial services.

**3.5. "Microfinance and Economic Development: A Comparative Analysis of Asian Countries" by David Lee (2022), Asia Pacific Journal of Development Studies.** Major findings: This comparative analysis investigated the role of microfinance in economic development across Asian countries. It revealed that countries with robust



microfinance sectors experienced higher levels of financial inclusion, reduced poverty rates, and increased economic growth.

**3.6. Kabeer, N. Year: 2001 Journal: World Development** Major Findings: The study highlights that microfinance can contribute to women's empowerment by enhancing their economic agency, increasing control over resources, and challenging gender norms

## 4. RESEARCH INTERPRETATION

### 4.1 Microfinance and Poverty Alleviation

Microfinance has indeed become an important poverty reduction tool in many parts of the world where people lack adequate access to different financial services. The chapter describes how microfinance helps in alleviating poverty, outlines some supporting empirical evidences, and reviews some criticisms in practice.

### 4.2 Mechanisms of Poverty Alleviation through Microfinance

Microfinance is most effective in poverty reduction through ensuring access to financial services to poor people and small enterprises so they can use such funds for profit-generating activities. Through microloans, MFIs enable clients to take out or expand small enterprises, potentially translating into higher income and better living standards (Banerjee et al., 2015). Such higher levels of income can result from improved consumption, better nutrition, improved health, improved education and better investments in children's education, which in turn can lead to a wider poverty alleviation cycle (Morduch, 2018).

Moreover, microfinance promotes savings behavior among low-income households. There are a great many MFIs who push clients towards savings by giving them low opening balance account, so as to build financial resilience to economic shocks (Rutherford, 2017). Savings have the ability to be used as a life cushion in emergency situations, so families can avoid borrowing money with sky-high interest rates (Schreiner, 2017). This financial stability is crucial for long-term poverty alleviation.

### 4.3 Empirical Evidence Supporting Microfinance Impact

Several authors set out to determine the impact of microfinance in fighting poverty. Banerjee et al. (2015) conducted a groundbreaking trial where they randomized subjects and found that with access to microcredit, households could significantly increase investments in their businesses and consumption levels. The research further pointed out that in general, these microloans had a positive impact on the income of the respondents, although the extent of the impact varied based on their wealth and business skills before getting the loans. Also, Karlan and Zinman (2017) observed that microfinance is beneficial to income but also that the magnitude of that benefit can be small. Moreover, the authors attach great importance to complementary services such as financial literacy and business incubation in fully realizing the poverty reduction potential of microfinance.

Again, the role and effect of microfinance on subsections of the population, in particular women, have become highly debated. A number of evidences points out that women with access to microfinance are more likely to focus on health and education of the family and, as a result, having a positive impact on the latter's future (Pitt et al., 2018). It is clear from research that loans directed at women lead to improved repayment rates and improved community development results, such that female borrowers are central contributors to poverty reduction schemes (Kabeer, 2019)

### 4.4. Women's Empowerment through Microfinance

Micro lending is powerful enough to be a key driver of a woman's self-empowerment economically especially in the developing countries' context (Hart, 1997). It is clear that women's economic achieved standing and their position in a the social discourse is improved when they have been given the access to financial resources and services (Banerjee et al., 2015). This chapter researches the relation that exists between microlending and women economic empowerment with a specific emphasis on women empowerment when leveraging financial services.

At the household level, studies have shown that when women have access to microcredit there is higher economic activity, household income and women's decision making (Hashemi et al., 1996). Informal micro lending has proven to be an effective method for women's financial empowerment, particularly in developing countries, as it allows women to access services that generally are out of their reach or are not available to them (Kabeer, 1999). It has also been observed that women entrepreneurs have been able to grow their businesses and positively impact their



communities through the aid of financial institutions that provide informal micro loans. Women in these communities traditionally are kept at the periphery of decision making and have limited control over finances which is why informal loans help when women are financially empowered, leading to gender equality in the economy (Chen, 2001). These women have reported being relieved from overbearing dependence on male family members, ultimately increasing their family role and overall market stability (Katz, 2011).

In Pakistan, for instance, the role of microfinance in improving women's economic standing by giving them easy access to finance has been noted with microlending institutions enabling building of assets and businesses through desegregation, where women are banked more broadly (Armendariz & Morduch, 2005). This is echoed by findings in Bangladesh, where formal support to women operated businesses has resulted in better health and increased earnings due to reduced overall work (Rahman, 2006).

Nonetheless, we need to be aware of the challenges and constraints within which women can benefit from microfinance. From a social perspective, women's financial participation and opportunities may be limited as a result of gender biases (Katz, 2011). Inadequate attention is being paid to issues of gender equity and social justice most likely as a direct outcome of microfinance's somewhat myopic focus on income achievement (Mayoux, 1999).

The literature reviewed, does corroborate microfinance as an optimum way for integrating women into the formal-financial system by ameliorating their economic status and enhancing their self-sufficiency. Still though it has been increasingly recognized over the past decades that more women's economic and sociopolitical progress is still needed, much research is still required to find out and contextualize the appropriate mechanisms for overcoming the intricacy microfinance entails within the context of women empowerment and the other wide range of treatment that these women are subjected to in the economic scenario. Tangible outcomes such as poverty reduction, better health, better education and women's greater agency and involvement in various decision making are all possible through microfinance especially in developing countries where women have no economic power.

## 5. CONCLUSION

To sum up, micro financing has opportunities and challenges in the context of economic development. Even though the concept has been proved to be an important instrument for poverty alleviation and empowering economies, its risks and criticisms necessitate a more careful examination of microfinance practices. Thus, in order for microfinance to prevent unwanted effects, stakeholders should ensure the effective use of the ideology by emphasizing transparency, responsible lending and appropriate framing of integrating support systems to the problem of poverty in a wider perspective. For instance, tackling the problem of social justice and stand both microfinance and Sg against gender discrimination. Evaluation of microfinance initiatives will assist the development processes and their complementary components for social equity and economic growth. The multidimensional debates on microfinance should bear more solutions through creativity and building capacity so that the vulnerable target population can prosper in a more egalitarian economy.

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