Chapter 8
Role of Microfinance Institutions in Development of India

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ABSTRACT

The role and contribution of microfinance institutions (MFIs) is very important in development. Microfinance is a very important source of financial services for people and microenterprises that do not have easy access to banking and related services. The objective of this chapter is to assess empirically the impact of MFIs on development of India. This study aims to fill a gap in econometric assessments of microfinance institutions. Using data of MFIs operating in India and using savings of client as proxy for development, this chapter found empirical evidence for significant positive impact of microfinance institutions on development. While development in rural regions generally lags behind urban areas, this chapter found no statistical evidence for differences in the marginal impact of microfinance institutions subject to geographical positions. It can therefore be concluded that impact of MFIs on development in rural areas is positive and independent of environment.

INTRODUCTION

The term “Micro Finance” is of recent origin though we do not find this word in textbooks dealing with finance and financial management. Now a day, it is commonly used in the media, national/international forums, literature relating to development and prosperity of relatively disadvantaged sections of the society (Kumudini, 2015).

The idea of microfinance was originally conceived by Muhammad Yunus (Yunus, 2007), a lecturer at a Bangladeshi University. The rationale behind microfinance was to provide capital to very poor people who could not afford to obtain finance from conventional sources due to various reasons (such as no collateral or guarantees) (Munir, 2014). In the modern world, microfinance is now considered an ultimate solution for endemic poverty (Henry, 2015). In 2005, UN considered microfinance as a critical anti-poverty tool (Kumah and Boachie, 2016). As a major anti-poverty too, microfinance has

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established a solid record of accomplishment. The microfinance industry witnessed a rapid growth in the last decade. According to an estimate, more than 130 million people are benefiting from microfinance facility (Investopedia, 2006). According to an estimate, worldwide there are more than 3 billion poor people (Basu, 2014). As such, the microfinance industry still has not reached 80% of its potential market. Financial services are a powerful tool that can enable poor people to build assets, increase income and reduce their income vulnerabilities. Poor people can use financial services (such as savings, loans etc.) to invest in businesses, improve living standards, and get better education for their children. Microfinance has been a powerful catalyst for women empowerment as well. Many factors are responsible for the current growth of microfinance industry worldwide. These factors include e.g. gap between supply and demand of financial services, expanded funding resources, and increased use of technology. During the development of microfinance industry, we have witnessed an increased number of regulated and licensed microfinance institutions (MFIs). These MFIs are focused on sustainability and responsible financial practices in all aspects of their business.

In the developmental paradigm, microfinance has evolved as a need-based policy program to cater to the so far neglected target groups (women, poor, rural, deprived, etc.). Its evolution is based on the concern of all developing countries for empowerment of the poor and the alleviation of poverty. Development organizations and policy makers have included access to credit for poor people as a major aspect of many poverty alleviation programmes. Microfinance programmes in the recent past have become one of the more promising ways to use scarce development funds to achieve the objectives of poverty alleviation. Furthermore, certain microfinance programmes have gained prominence in the development field and beyond. The basic idea of microfinance is simple: if poor people are provided access to financial services, including credit, they may be able to start or expand a micro-enterprise that will allow them to break out of poverty. Thus, micro-finance has become one of the most effective interventions for economic empowerment of the poor. Microfinance is an economic development approach that involves providing financial services, through institutions, to low-income clients, where the market fails to provide appropriate services (Kumudini, 2015).

The services provided by the Microfinance Institutions (MFIs) include credit saving and insurance services. Many microfinance institutions provide social intermediation services such as training and education, organizational support, health and skills in line with their development objectives. Microfinance is considered as a tool for socio-economic development of people and for financing small scale activities/technological applications in the rural areas. It Provide credit for investment in small scale activities chosen by the poor people, empower the poor to build self-confidence, allow developing opportunities for self-employment to the underserved people, having the broadest utility and the least cost per beneficiary. Microfinance is a credit methodology, which employs effective collateral substitute for short-term and working capital loans to micro-entrepreneurs. The level of a country’s poverty has long been linked with measures of its economic development. Microfinance has demonstrated its potential to assist the poor to make significant strides towards reducing their exposure, improving their purchasing power, paying for basic health care and bearing their children’s education expenses (Littlefield et al., 2003). Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women’s Association (“SEWA”) of the state of Gujarat formed an urban cooperative Bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganized sector in Ahmadabad City, Gujarat. The continuous failure of the formal financial system to deliver credit and other financial services to the poor and the realization of potential role of microfinance in poverty alleviation led to the emergence of microfinance in India. Microfinance
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