International Journal of Advances in Engineering and Management (IJAEM)
Volume 3, Issue 8 Aug 2021, pp: 1019-1023 www.ijaem.net ISSN: 2395-5252

Opportunities and Threats in Micro Finance

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Submitted: 01-08-2021 Revised: 14-08-2021 Accepted: 17-08-2021

ABSTRACT:"Micro finance is an innovative technique to providing savings and investing opportunities to the underprivileged all over the world. It is gaining popularity in India and throughout the world as a viable tool for economic development and poverty reduction. According to studies, over 37 percent of India's population lives in poverty.The benefits of Microfinance Institutions (MFI) in India shall be the subject of this article. Existing structure has a lot of drawbacks, but if combined with skill and opportunity development for the poor, it has the potential to change the socioeconomic profile of India's poor."

I. INTRODUCTION

Microfinance in India has a long history dating back to the foundation of Syndicate Bank in the private sector in 1921. Syndicate Bank focused its early years on raising micro deposits on a daily/weekly basis and sanctioning micro loans to its clients for a shorter length of time. But it wasn't until Dr. Yunus' Grameen Bank experiment that microfinance became well-known.

Microfinance is the provision of financial services to low-income clients, such as consumers and small business owners, who have traditionally been denied access to banking and related services. In practice, the phrase is frequently used to refer to loans and other services provided by companies that call themselves microfinance institutions (MFI). This institution frequently employs new ways developed over the previous 30 years to provide modest loans to unemployed borrowers who accept small loans with no collateral. This strategy entails group lending and liability, pre-loan saving requirements, gradually growing loan amount, and an implicit guarantee of quick access to a future loan if the current loan is returned in full and on time.

Micro finance

Micro finance, often known as micro credit, is a sort of banking service offered to low-income or jobless individuals or groups that would otherwise be unable to obtain financial services.

Microfinance as we know it today, has been popularised by Muhammad Yunus, winner of the Nobel Peace Prize in 2006. Dr Yunus referred to as the 'banker of the poor' has been the founder of the first micro-credit institution, the Grameen Bank in 1976 in Bangladesh. But formally, other bodies had already existed even in Europe. For example, we can cite Raiffeisen founded in Switzerland in 1849, the first savings and credit cooperative. Then the 'Caisse du Crédit Mutuel' is created in Strasbourg in 1849, strongly inspired by the Swiss model.

Beyond the institutions that have taken on a banking character, informal systems have existed indeed. One of the most known being 'la tontine'. It is a group of people that regularly meet and that save together in order to then invest in a project or to meet the needs of a saver. Each individual thus benefits from a saving during their lifetime. This will of course have to be refunded within a given period.

As a result, poor people may find themselves trapped in a vicious cycle of poverty for a long time, if not permanently. Microfinance, which was first developed by Muhammad Yunus, a Bangladeshi economist, in the early 1970s, is one of the solutions to this problem.

Yunus founded the Grameen (village) Bank of Microcredit in Bangladesh. The bank was founded on Yunus' idea that credit is a strong weapon, and that poor people's access to credit is critical to the development of a just and ethical society in which people can live with dignity and hope for the future. Credit, according to Yunus (1997), "unlocks the door to all other important human rights: food, housing, and education."
(1998, Bransma and Chaouali) Many countries' experience has shown that the poor are creditworthy and will pay a premium for dependable and quick credit. These approaches have also demonstrated that banking with the impoverished may be both profitable and long-term.

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Characteristics ofMicroFinance

1. Microfinance is a type of lending that focuses on providing small, short-term loans to underprivileged farmers and communities. Farmers and villagers will utilize the funds to raise crops, purchase farm animals, or create microbusinesses.
2. It's a different way of looking at collateral. The most common form of collateral for micro loans is peer pressure rather than tangible goods.
3. It is a reasonably simple and quick method of assessing the borrowers' qualifications. This means that there will be no long wait times and that the evaluation process will be quick with minimal paperwork.
4.An interest rate that is greater than the market rate to compensate transaction costs. Microfinance institutions may not be able to survive if these expenditures are not covered.
5. Repayment rates that are extremely high.
6. Borrowers will have simple access to financial services because to handy locations.

Microfinance has been used in a variety of ways in numerous nations, with varying results and success rates. Despite their differences in tactics, all of these countries have one thing in common: credit services are provided to the poor on a long-term basis, and microfinance creates jobs and generates revenue.Increased income for the poor helps to alleviate poverty and contributes to the country's economic development, particularly in rural areas. As a result, microfinance may be viewed as a vital practice that can assist countries in moving toward a higher quality of living and a more hopeful future for people trapped in poverty.

Principles of Micro Finance:

- ❖ **Costs are being covered**: Microfinance institutions must be able to cover their loan expenses in order to be viable.
- ❖ **Getting to a given point on a scale**: Microfinance institutions must attain a particular scale to be successful, which is determined by the number of clients and active loans.
- ❖ **Subsidies are avoided**: Subsidies to clients were impossible for microfinance organizations to provide. Borrowers should understand that microcredit is a loan, not a gift, and that they are responsible for repaying it. Furthermore, microfinance institutions could not rely on government or private-sector subsidies indefinitely. To put it another way, microfinance organizations should be financially sound.
- ❖ **Promoting demand-driven service delivery and outreach:** Microfinance institutions must expand their services and give credit to the growing number of low-income families if they are to succeed. Peer pressure is utilized as an alternative kind of collateral to urge borrowers to repay their loans on time, even though there is no real or financial asset collateral.
- ❖ **Keeping a laser-like focus:** Microfinance institutions should have a distinct focus and should not mix their services with other social services like education and health care. The basic goal of microfinance institutions should be to provide poor people with access to credit and financial services.

Microfinance Institution

The majority of microfinance institutions are found in underdeveloped countries. They differ in terms of structure, sophistication, philosophy, size, service scope, and operational scale. The majority of microfinance firms offer small loans to the needy in the communities where they operate. Some also offer other financial services like insurance, micro-mortgages, and savings accounts.

Employees of microfinance organizations visit with borrowers in their towns and villages or run local branch offices to give services. They meet with their clients on motorcycles, bicycles, or on foot, often over vast distances. They organize borrowers' meetings, give training, and are in charge of making and collecting loans.

When microfinance institutions become financially successful, self-sustaining, and vital to the communities in which they operate, they have the potential to attract additional resources and extend client services. According to the success of microfinance institutions, just approximately 2% of the world's about 500 million small business owners have access to financial services, according to Barry et al.1996.Although there is a demand for lending among the poor and women at market interest rates, microfinance institutions must reach a specific volume of financial transactions before their financial operations can become self-sustaining.

Structure of Microfinance in India

People living in poverty lack the resources and information necessary to obtain financial assistance. Microfinance is a significant tool in this situation. In India, the following structure exists.

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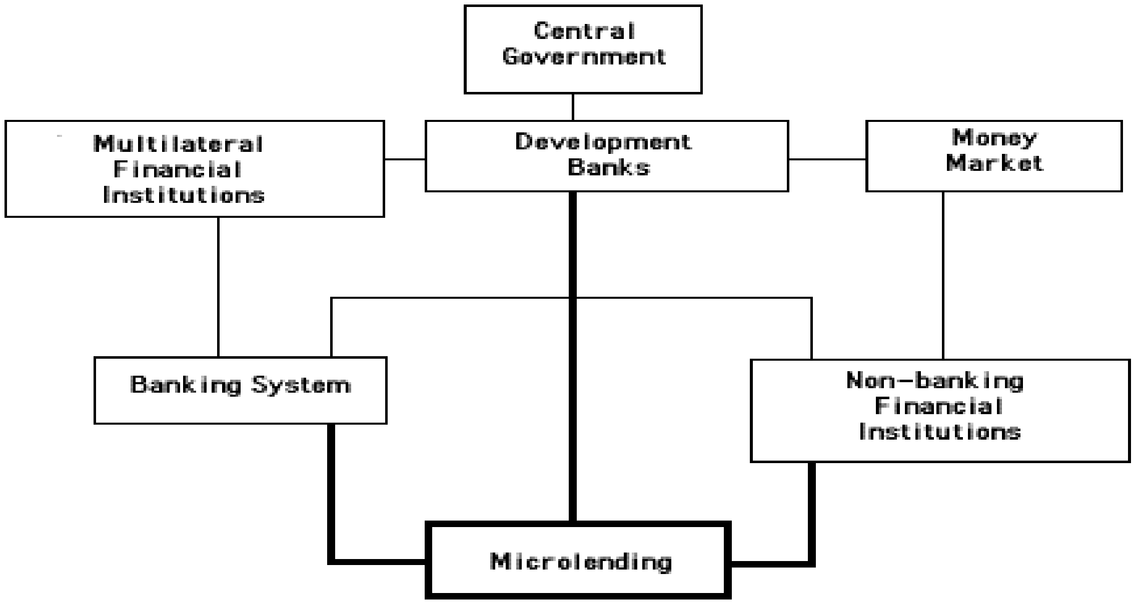

Process Chart of Micro Finance

Traditionally, India's formal banking institutions have focused on meeting the requirements of the commercial sector and giving loans to people in the middle- and upper-income brackets. Similarly, because of the perceived dangers of lending to this sector, HFIs have not developed a house financing product to meet the demands of the Very LIG (Low Income Group).

Following risks are generally perceived by the formal sector financial institutions:

- ✓ Credit Risk
- ✓ High transaction and service cost
- ✓ Absence of land tenure for financing housing
- ✓ Irregular flow of income due to seasonality
- ✓ Lack of tangible proof for assessment of income
- ✓ Unacceptable collaterals such as crops, utensils and jewellery

So,these institutions are unable to finance low-income group .to overcome with these risk centre and state government provide facility for services. these figures are self-explanatory that how important are this institution. As far as the formal financial institutions are concerned, there are Commercial Banks, Housing Finance Institutions (HFIs), NABARD, Rural Development Banks (RDBs), Land Development Banks Land Development Banks and Co-operative Banks (CBs).

Threats Faced by Micro Finance:

India's microfinance sector has been quickly expanding in both scope and institutional diversity, making it the world's largest. The Challenges of Rapid Growth is a detailed examination of the many aspects of the Indian microfinance industry.

- ❖ According to a World Bank research, 59 percent of rural households in Andhra Pradesh and Uttar Pradesh do not have access to a bank account, while 78 percent do not have access to credit. Given the fact that the majority of the 360 million impoverished households (urban and rural) do not have access to formal financial services, the number of clients to reach, and the type and quantity of offerings.
- ❖ Only a small portion of this US$30 billion potential market has been reached so far, and MFIs and NGOs are unlikely to be able to address it alone. To break into this sector, you'll need a lot of money, technology, and people. However, public sector institutions continue to control 80% of the financial sector.
- ❖ Competition, consolidation, and convergence are all being discussed as ways to improve efficiency and outreach, but there is still significant opposition; for example, the All-India Bank Employees Association has threatened to strike if the government continues with its policy of reducing capital in public sector banks, merging public sector banks, or even increasing Foreign Direct Investment in Indian private banks.
- ❖ Several presenters at the Microfinance India conference discussed the widening and rising divide between South India's rapid growth and stagnation in Eastern, Central, and North

Eastern India. Microfinance is unlikely to be able to solve the enormous problems of underdevelopment, poor infrastructure, and bad governance on its own.

Opportunities for Micro Finance

The Indian microfinance industry (MFI) feels that the sector is a solid investment opportunity, and that capital adequacy will not be a problem in the near future. This air of hope comes as the Reserve Bank of India (RBI) has announced that the capital adequacy ratio (CAR) for MFIs will be increased to 15% in April 2011.

CAR is the minimum amount of cash that a financial institution, such as a bank or a microfinance institution, keeps aside as a percentage of its asset base or loan book. While commercial banks are required to have a CAR of 9%, MFIs are currently required to have a CAR of 12 percent. Tier-I capital (defined as core equity and retained earnings) for MFIs would be increased from 8% to 12%.Tier-II (debt or borrowings) is expected to be around 3%. “In the Indian banking and financial environment, the MFI sector represents the fastest growing sector. It has been able to attract interest among investors due to low levels of non-performing assets (NPAs),” says Kolkata-based Bandhan Microfinance, which has a CAR of 18 percent and feels it has potential to grow lending.

II. DISCUSSION:

- Microfinance is a vital instrument for emerging and underdeveloped countries to enhance their population's overall living standards. In the 1970s, Bangladesh became the first country to do so.
- India is a developing country with 37.6% of the population living in poverty, and 20% of the poorest individuals have access to financial services. After 1992, the state of Andhra Pradesh took the lead in this regard.
- In 2006/07, the strongest impulse came from medium-often urban-MFIs, and in 2007/08, it came from large MFIs.
- 4.1 million consumers from SC/ST backgrounds are served by Indian MFIs.The reported number of SC/ST has been increasing in tandem with the rate of total outreach, resulting in a consistent SC/ST - share of 3 out of 10 clients.
- Almost everyone is involved in numerous activities that pay over $10,000 per month and allow them to improve their business and marketing skills.
- To efficiently deploy supervisory resources, especially where depository microfinance represents a minor part of the financial system but contains a large number of small institutions.
- To build specialized knowledge within the supervisory team in order to effectively assess the risk of micro finance activities, notably micro lending.
- Recognize traditional banking's proven control and management procedures, which may be applicable to the microfinance sector in both small and large institutions.

III. CONCLUSION:

In this paper, we outline the principles and practices of microfinance, as well as the critical role of microfinance in the lives of those living in poverty. Microfinance institutions are founded on the belief that everyone in the economy is entitled to fair treatment.Microfinance organizations believe in collateral loans and that everyone, especially the impoverished, is creditworthy and should be allowed to engage in local economic activity. Microfinance has been shown to be a successful tool for economic development and poverty alleviation.Microfinance in India is confronted with high transaction costs and interest rates when serving small customers, however the MFI sector represents a faster expanding sector in the Indian banking and finance environment, with increasing lending. MFIs provide job opportunities to help people get out of poverty.

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