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# MICROFINANCE IN INDIA

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## ABSTRACT

*Microfinance, also called microcredit, is a type of banking service that is provided to unemployed or low-income individuals or groups who otherwise have no other access to financial services. While institutions participating in the area of microfinance are most often associated with lending (microloans can be anywhere from $100 to $25,000), many offer additional services, including bank accounts and micro-insurance products, and provide financial and business education. Ultimately, the goal of microfinance is to give impoverished people an opportunity to become self-sufficient. Microfinance is a general term to describe financial services, such as loans, savings, insurance and fund transfers to entrepreneurs, small businesses and individuals who lack access to traditional banking services.The pioneer of modern microfinance is often credited to Dr. Mohammad Yunus, who experimented with making small loans, which he funded himself, to women in Bangladesh making bamboo furniture who had previously relied on usurious loans to purchase raw materials. He discovered these very tiny loans, which traditional banks did not want to make due to the perceived risks and costs, could make a disproportionate difference to a poor person and given the chance they would pay them back creating a viable business model. He would go on to found Grameen Bank in 1983 and win the Nobel Peace Prize in 2006.*

**KEYWORDS:** Microfinance, MicroCredit, Financial Inclusion, Micro entrepreneurs

**Introduction:**

Microfinance is a provision of micro loan to the poor entrepreneurs and small businesses lacking access to banking and related services. Microfinance is defined as, financial services such as savings accounts, insurance funds and credit provided to poor and low income clients so as to help them increase their income, thereby improving their standard of living. Over time, Microfinance has emerged as a larger movement whose object is "a world in which as everyone, especially the poor and socially marginalized people and households have access to wide range of affordable, high quality financial products and services, including not just credit but also savings, insurance and fund transfers." Many of those who promote microfinance generally believe that such access will help poor people out of poverty, including participants in the Microcredit Summit Campaign. For many, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses; for others it is a way for poor to manage their finances more effectively and take advantage of economic opportunities while managing the risks. The terms have evolved - from micro-credit to micro-finance, and now 'financial inclusion'.

**Review of Literature:**

Review of literature paves way for a clear understanding of the areas of research already undertaken and throws a light on the potential areas which are yet to be covered. Keeping this view in mind, an attempt has been made to make a brief survey of the work undertaken on the field of Microfinance. The reviews of some of the important studies are presented below.

1. Shastri (2009) quoting an important study of 2005 – 2006, a survey of India’s leading 15 MFIs shows the industry’s strength in both size and growth. While MFIs globally and within the region average less than 20,000 clients per institution,well managed Indian micro finance institutions already rank top in outreach. Not to be left behind, Indian institutions top the charts of all 78 countries surveyed in 2005 for their phenomenal growth rates, the median leading MFI doubling coverage in a single year.

2. Satya Sundaram (2007) has a comprehensive work on microfinance in India.Here he argues that microfinance is one of the innovative schemes to help the poor, but they met limited success. He suggests that the self help groups are empowering the rural poor by providing them access to institutional credit and other relevant services. The SHGs lay stress on thrift, training and

capacity building. Emphasis is placed on educating the members on social issues also.

3. Madhura Swaminathan (2007) in her article “The micro credit alternative”, explains the micro credit has been receiving a significant amount of attention all over the world especially in developing countries. She states that by providing micro credit to the poor people, the gap in the formal credit sector can be filled.

4. Fernandez (2007) also specifies the development of micro finance in India and it's linkage with SHGs. M P Vasumalai and K. Narender (2007)20 give a brief picture of results of functioning ‘Kalanjiam Community banking programme based on TamilNadu. In their words Kalanjiam is a unique micro credit programme in south India and one of the largest micro finance programme in Asia and probably largest programme in the world. As on September 2006 the programme has an outreach of 347955 poor women spread over 139 locations covering 6605 villages. The writer try to prove that this programme reduce poverty in the country.The report namely “Micro finance Industry in India is a case study of Indian Centre for Management Research”21 presents a detailed overview of the microfinance industry in India. The advent of new millennium witnessed significant developments in the Indian microfinance industry, which attracted the attention of several private sector and foreign banks. The report analyzes the potential of Indian microfinance industry and examines the recent policies of Indian government to boost the growth of

the industry. Finally, the report examines the challenges facing the industry in the near future.

5. Debadutta K Panda, (2009) also focuses on Indian microfinance scenario. It gives an in-depth understanding on microfinance products, supported by relevant case studies and examples. The different components of microfinance in the Indian context are discussed with suitable examples such as demand and supply of microfinance,intermediation and regulations and so on. He analyzes the role of microfinance and microfinance institutions in natural disasters and also scans various microfinance lending models practiced throughout the world, and focuses on the models practiced in India. The book concludes with discussions on microfinance as a tool for poverty alleviation, social development, women empowerment, microenterprise development and socio-economic development of rural and urban poor, and is supported with many real cases drawn from the field.

6. Prabhu Gate (2007) gives a series of annual reports on the microfinance sector in India. It is a comprehensive one-stop document that provides a holistic view of the sector, providing a

detailed analysis of its status and future. It highlights recent developments under each of the two main models of microfinance in India - the SHG and MFI models. The author in another article outlines a case study of the episode in 2006 in Krishna district of Andhra Pradesh when the state government temporarily closes down all the branches of microfinance there. The case study helps provide insights into the kind of consumer protection issues of relevance to Indian microfinance.

7. Sriram M S and Radha kumar (2007) analyzed the reason behind the regional skewness of microfinance institutions in India. The article concludes that there is no macroeconomic or demographic reason as to why microfinance emerges in certain regions. Using the summary of the data, the writers assume that microfinance naturally emerges in places where the economic growth is slow, the connectivity is low, the poverty incidence is high, with dense population and a failure of formal financial institutions.

8. Radha G. Friedman (2005) conducted a study about the impact of Indian microfinance industry on poor especially women by taking two MFI s from South India; Jaya sangham Chennai and Prem Sangham Visakha Patanam. Both institutions are started its operations around 25 years back the functioning mainly concentrated among women. In 2005, Jaya Sangam owns its own cooperative bank and has more than 225,000 members in nine branches across the three southern states of TamilNadu, Andhra Pradesh, and Karnataka, and is considering expanding north into the state of Bihar. Prem Sangam provides programs and services to 185 villages spread out over a 100 KM radius. Both MFIs studied, revealed an unequivocal welfare St inclination in their mission, programs, and policies, which would suggest that they are far less easily influenced by policy from international development institutions.

**Objectives:** The following are the Objectives of the Study;

1. To Study the History of Microfinance
2. To Study the Need of Microfinance
3. To Study the Microfinance in India
4. To Study the Present Scenario of Microfinance in India
5. To Study the Types of Microfinance
6. To Study the Features of Microfinance

7. To Study the Benefits of Microfinance

8. To Study the Challenges of Microfinance

9. To Study the Impact and Critism of Microfinance

10. To Offer Conclusion

**Research Methodology:**

The prepared paper is a descriptive study in nature. The study has been carried out based on the collection of the relevant secondary data. Secondary data collection was based on various sources such as published books, articles published in different journals & newspapers, periodicals, conference paper, working paper and websites, etc.

**History of Microfinance:**

The history of microfinance begins in the 1970s in rural Bangladesh, but there is evidence that in the APAC region, informal lending and borrowing has been taking place for centuries. Our first modern microfinance transaction of record involves a Professor named Doctor Muhammad Yunus, who was employed at the time by the University of Chittagong in their Economics department.Yunus was determined to find a practical solution to help small villages struggling in the midst of a mighty famine. As he toured the region, he noticed in the village of Jorba that a group of women were making bamboo stools. These women were stuck in a cycle of debt because they were forced to borrow funds for the raw materials for the stool, then forced to sell the stools at a razor-thin margin.When Yunus investigated what their borrowing needs would be to end this repressive cycle of debt, he couldn't believe that the amount was just $27. He pulled out his wallet, loaned the money to these women without interest, and this helped them be able to move away from the local traders.

This became the foundation of what would eventually become the Grameen Bank Project. They have proved that even those who are in abject poverty have the ability to bring about their own development.The Grameen Bank is an organization that is dedicated to microfinance. It is a community development bank that was founded in Bangladesh to provide small loans to those in need without the requirement of collateral in return. Starting Jobra where Yunus made his first loan, this project incorporated neighboring villages from 1976-1979 to expand the provision of banking services to the rural poor of the region.In these early years, the Grameen Bank Project was sponsored by the central bank of Bangladesh and several nationalized commercial banks. This allowed the project to continue expanding and by 1983, it would be transformed into an independent bank through government legislation.In 2006, Yunus and the Grameen Bank were awarded the Nobel Peace Prize for their work. The project was also a winner of the World Habitat Award. The duo have also received numerous international recognitions, including the US Presidential Medal of Freedom, the Congressional Gold Medal, and being ranked #2 in Foreign Policy magazine's list of the Top 100 Global Thinkers of today.

It currently operates over 2,500 locations, employs more than 22,000 people, and has a net operating income that was last reported to be over 12 billion Taka, or the equivalent of $120 million.In 2011, the Bangladeshi government forced Yunus to resign from the bank due to his age. Today, the borrowers from the bank own 90% of its shares, with the other 10% being owned by the government. This means the rural poor own the financial institution which has helped to pull many of them out of abject poverty.

**Need of Micro Finance:**

About half of the Indian population still doesn't have a savings bank account and they are deprived of all banking services. Poor also need financial services to fulfil their needs like consumption, building of assets and protection against risk. Microfinance institutions serve as a supplement to banks and in some sense a better one too. These institutions not only offer microcredit but they also provide other financial services like savings, insurance, remittance and non-financial services like individual counselling, training and support to start own business and the most important in a convenient way. Some claim that the interest rates charged by some of these institutions are very high while others feel that considering the cost of capital and the cost incurred in giving the service, the high-interest rates are justified.

**Microfinance in India:**

Since the 1980s microfinance has become an important component of development, poverty reduction and economic regeneration strategies around the world. By the early twenty-first century, tens of millions of people in more than 100 countries were accessing services from formal and semi-formal microfinance institutions. Microfinance rests on the belief of mutual faith and reciprocity. Members in a genuine, self-selected and closely associated group are mutually responsible for the financial dealing of each member. When a request for a loan is received, members discuss the need and prospects of repayment. Once satisfied, the loan amount is approved. Group lending is preferred to individual lending as social collateral, peer pressure and good collection methods reduce defaults significantly. Microfinance loans are primarily unsecured and work on the principles of peer pressure to avoid defaults. Microfinance serves low-income households and encourages the spread of banking services. Financial inclusion is essentially providing banking services to the population derived from this facility. Microfinance is thus an enabler for promoting financial inclusion.

Those institutions which have microfinance as their main operation are known as microfinance institutions. A number of organizations with varied size and legal forms offer microfinance service. These institutions lend through the concept of Joint Liability Group (JLG). A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee. The reason for the existence of separate institutions i.e. MFIs for offering microfinance are as follows:

- High transaction cost – generally micro-credits fall below the break-even point of providing loans by banks
- Absence of collaterals – the poor usually are not in a state to offer collaterals to secure the credit
- Loans are generally taken for very short duration periods
- Higher frequency of repayment of instalments and the higher rate of Default.
- Salient Features of Microfinance
- Borrowers are from the low-income group
- Loans are of small amount – microloans
- Short duration loans
- Loans are offered without collaterals
- High frequency of repayment

- Loans are generally taken for income generation purpose

**The Malegam Committee:**

The Reserve Bank of India (RBI) responded by appointing an RBI sub-committee known as the Malegam Committee. This committee aimed to address the primary customer complaints that led to the crisis, including coercive collection practices, usurious interest rates, and selling practices that resulted in over-indebtedness. The existing regulations did not address these issues, thus, who should respond to these issues, and how they should respond, was uncertain. This prolonged the general regulatory uncertainty and the resulting repayment and institutional liquidity issues. The Malegam Committee released their recommended regulations in January 2011. These recommendations were 'broadly accepted' by RBI in May 2011, though specific regulation was only released regarding which institutions qualify for priority sector lending at this time. Additionally, an updated version of the Micro Finance Institutions (Development and Regulations) Bill 2011 is in Parliament, which aims to provide a regulatory structure for microfinance institutions operating as societies, trusts, and cooperatives. Although this shows that regulators are taking steps to address the crisis issues and resolve regulatory uncertainty, banks have not resumed lending to microfinance institutions as of July 2011.

**Present scenario of India:**

- India falls under low-income class according to World Bank.
- It is second populated country in the world and around 70% of its population lives in rural area
- 60% of people depend on agriculture, as a result, there is chronic underemployment and per capita income is only $6490
- The result is abject poverty, low rate of education, low sex ratio, and exploitation.
- Low asset base- according to reserve bank of India, about 51% of people house possess only 10% of the total assets of India.
- Resulted in low production capacity both in agriculture (which contribute around 22-25% of GDP) and manufacturing sector

- Rural people have very low access to institutionalized credit (from commercial bank).

**Types of Microfinance:**

Different types of microfinance institutions in India The microfinance models are developed in order to cope with the financial challenges in financially backward areas. There are various types of microfinance companies operating in India.

**Joint Liability Group (JLG):** Joint Liability Group can be explained as the informal group consists of 4-10 individuals who try to avail loans against mutual guarantee from banks for the purpose of agricultural and allied activities. This category generally consists of tenants, farmers and other rural workers. They work primarily for lending purposes, although they also offer the savings facility. In this type of institution, every individual of a borrowing group is equally liable for the credit (Singh, 2010). This kind of institution is simple in nature and requires little or no financial administration (UBI, no date).However, one of the serious problems of this structure is personal preferences in lending credit which resulted in a partial failure of the system. Of late due to various promotional initiatives were taken by banks such as Indian bank, Karur Vysya Bank and Indian Overseas Bank, the credibility of Joint Liability Group model has received a boost (The Hindu, 2016). It still remains a landmark movement in the area of protection of farmer's land ownership rights.

**Self Help Group (SHG):** Self Help Group is a type of formal or informal group consisting of small entrepreneurs with similar kind of socio-economic backgrounds. Such individuals temporarily come together and generate a common fund to meet the emergency needs of their business. These groups are generally non-profit organizations. The group assumes the responsibility for debt recovery. The advantage of this micro-lending system is that there is no need for collateral. Interest rates are also generally low and fixed especially for women (Chowdhury, 2013; Business Standard, 2017). In addition, various tie-ups of banks with SHGs have been implemented for the hope of better financial inclusion in rural areas (Jayadev and Rao, 2012).One of the most important ones is NABARD SHG linkage program where many self-help groups can borrow credit from the bank once they successfully present a track record of regular repayments of their borrowers. It has been very successful especially in Andhra Pradesh, Tamil Nadu, Kerala and Karnataka and during the year of 2005-06. These states received approximately 60% of SGH linkage credit (Taruna and Yadav, 2016).

**The Grameena Model Bank:** Grameen Model was introduced by the Nobel laureate Prof. Muhammad Yunus in Bangladesh during the 1970s. It has been widely adopted in India in the form of Regional Rural Banks (RRB). The goal of this system has been the overall development of the rural economy which generally consists of financially backward classes. But this model has not been fully successful in India as rural credit and system of recovery are a real problem. A huge amount of non-performing assets also led to the failure of these regional banks (Shastri, 2009). Compared to this model Self Help Groups have been more successful as they are more suited to the population density of India and far more sustainable.

**Rural Cooperatives:** Rural Cooperatives in India were set up during the time of independence by the government. They used the mechanism to pool the resources of people with relatively small means and provide financial services. Due to their complex monitoring structure, their success has been limited. In addition, this system only catered to the credit-worthy individuals of rural areas, not covering a large part of the country's financially backward section.

**Features of Microfinance:**

The main features of microfinance are:

1. Loan given without security
2. Loans to those people who live below the poverty line
3. Members of SHGs may benefit from micro finance
4. Maximum limit of loan under micro finance Rs.25,000/-
5. Terms and conditions offered to poor people are decided by NGOs
6. Microfinance is different from Microcredit- under the latter, small loans are given to the borrower but under microfinance alongside many other financial services including savings accounts and insurance. Therefore, microfinance has a wider concept than microcredit.
7. In June 2014, CRISIL released its latest report on the Indian Microfinance Sector titled "India's 25 Leading MFI's". This list is the most comprehensive and up to date overview of the microfinance sector in India and the different microfinance institutions operating in the sub-continent.
8. Many loan officers in India create emotional connection with borrowers before loan reaches

maturity by mentioning details about borrowers' personal life and family and also demonstrating affection in many different ways as a strategy to generate pressure during recovery.

**Microfinance Benefits:** The following are the benefits of microfinance. They are

**1. It allows people to better provide for their families:**

Microfinance allows for an added level of resiliency in the developing world. Even when households are able to work their way out of poverty, it often takes just one adverse event to send them right back into it. It's often a health care issue that causes a return to poverty. By allowing entrepreneurs to become more resilient through their own efforts at their own business, it gives them the opportunity to make it through times of economic difficulty. Most of the households that take advantage of the microfinance offers that are available in developing countries live in what would be considered "abject poverty." This is defined as living on $1.25 per day or less – though some definitions extend this amount to $2 per day or more. About 80% of that amount goes to the purchase or creation of food resources.By offering microfinance products that can be repaid with that remaining 20%, more households have the opportunity to expand their current opportunities so that more income accumulation may occur.

2**. It gives people access to credit.**

Muhammad Yunus, who is often credited as the modern father of microfinance, once gave $27 to women out of his own pocket because he saw how the cycle of debt affected their work crafting bamboo chairs. Most banks will not extend loans to someone without credit or collateral because of the risks involved in doing so, yet those in poverty do not have any credit or collateral.By extending microfinance opportunities, people have access to small amounts of credit, which can then stop poverty at a rapid pace.Yunus has always believed that credit is a fundamental human right. There are certainly some financial institutions which may disagree with his assessment. Yet without credit, it can be difficult, if not impossible for someone in poverty, to pursue an idea that could bring about a giant payday one day. Microfinance makes that pursuit possible.

**3. It serves those who are often overlooked in society.**

In many developing nations, the primary recipient of microloans tends to be women. Up to 95% of some loan products are extended by microfinance institutions are given to women. Those with disabilities, those who are unemployed, and even those who simply beg to meet their basic needs are also recipients of microfinance products that can help them take control of their own lives.Women are key figures in leadership roles in business, even in the developed world. Catalyst has reported that companies with female board directors are able to obtain returns that are up to 66% better in returns on invested capital and 42% better in terms of sales returns than companies with male board members only.Women also develop others more frequently when it comes to entrepreneurial roles. This comes from coaching, feedback, or investments. Even in the developed world, women helping women is an economic force that poverty can't stop.

**4. It offers a better overall loan repayment rate than traditional banking products.**

When people are empowered, they are more likely to avoid defaulting on a loan. Women are also statistically more likely to repay a loan than men are, which is another reason why women are targeted in the microfinance world. There's also the fact that for many who receive a microloan, it is their only real chance to get themselves out of poverty, so they're not going to mess things up.Zenger Folkman published a survey regarding ratings of high integrity and honesty in leadership roles that was separated by gender. The mean percentile of women displaying these traits was 55%, while for men, it was just 48%. In business, the bottom line is this: integrity matters. Microfinance institutions have recognized this and approached women because of this.As a side effect of this approach, many developing countries are taking a new look at what role women should play in society. Instead of treating a woman as a second-class citizen, or the "barefoot in the kitchen and pregnant" attitude that has been prevalent in the past, the success of women in bring their households out of poverty is evidence that proves women not only have an initiative to get things done, but they produce consistent results.For these reasons, microfinance institutions see total repayment rates of higher than 98%, though there can be several accounts that are overdue at any given time.

**5. It provides families with an opportunity to provide an education to their children.**

Children who are living in poverty are more likely to have missed school days or to not even be enrolled in school at all. This is because the majority of families who live in poverty are working in the agricultural sector. The families need the children to be working and productive so their financial needs can be met. By receiving microfinancing products, there is less of a threat of going without funding, and that means more opportunities for children to stay in school.This is especially important for families with girls. When girls receive just 8 years of a formal education, they are four times less likely to become married young. They are less likely to have a teen pregnancy. In return, this makes girls more likely to finish schooling and then either obtain a fair-paying job or go onto a further educational opportunity.

**6. It creates the possibility of future investments.**

The problem with poverty is that it is a cycle that perpetuates itself. When there is a lack of money, there is a lack of food. When there is a lack of clean water, there is a lack of sanitary living conditions. When people are suffering from malnutrition, they are less likely to work. A lack of sanitation creates the potential of illness that prevents working days.Microfinance changes this by making more money available. When basic needs are met, families can then invest into better wells, better sanitation, and afford the time it may take to access the health care they need.As these basic needs are met, it also means that there are fewer interruptions to the routine. People can stay more productive. Kids can stay in school more consistently. Better healthcare can be obtained. This creates a lower average family size because there are more guarantees of survival in place.And when that happens, the possibility of future investments will occur because there is more confidence in being able to meet basic needs.

**7. It is a sustainable process.**

How much risk is there with a $100 loan? Some investors might pay that for a decent dinner somewhere. Yet $100 could be enough for an entrepreneur in a developing country to pull themselves out of poverty. This small level of working capital is sustainable because it's essentially a forgettable amount.If there is a default on that money, the interest and high repayment rates of other microloans will make up for it. Then repayments are reinvested into communities so that the benefits of microfinance can be continually enhanced. Each repayment becomes the foundation of another potential loan.This is why many microfinance products have relatively high interest rates. Some institutions may charge the equivalent of a 20% APR, but others have interest rates which exceed 800%. Although interest is high, recipients are invested into making these products work because virtually all institutions put repayments back into new loans that target the most vulnerable households in the developing world.

**8. It can create real jobs.**

Microfinance is also able to let entrepreneurs in developing countries be able to create new employment opportunities for others. With more people able to work and earn an income, the rest of the local economy also benefits because there are more revenues available to move through local businesses and service providers.It's not just the entrepreneurial level that benefits from job creation through microfinance. Grameen Bank in Bangladesh employs over 21,000 people and their primary financial products are related to microfinance. That's tens of thousands of jobs that are created by the industry with the sole purpose of being able to drag people up and out of poverty.

**9. It encourages people to save.**

Microloans are an important component of microfinance, but so is saving money. When people have their basic needs met, the natural inclination is for them to save the leftover earnings for a future emergency. This creates the potential for more investments and ultimately even more income for those who are in the developing world.Some microfinance institutions have seen an extraordinary number of savings occur when products are extended. The Unit Desai of Bank Rakyat Indonesia counts 28 million savers to just 3 million microloan borrowers.Now saving isn't always seen, especially from borrowers, but this is part of the expected microfinance process. Small loans make small financial improvements for households living in poverty. The difference between making $1.90 per day and $2.30 per day is not much in reality, but by definition, that amount takes someone out of extreme poverty.Instead of big improvements, microfinance allows for small improvements. When enough of those improvements occur, then there is a safe place for people to store their income thanks to this industry.

**10. It reduces stress.**

There is a valid argument to be made that some microloans go to cover household expenses instead of business needs. Some are using these loans to pay bills or purchase food. It's true. Yet without this product available, there wouldn't be an ability to pay bills or purchase food. So even though it may not always be used for business purposes, it still serves a purpose by reducing stress.Stress cannot be underestimated when it comes to poverty. Even in the developing world, the stresses of poverty can be overwhelming. It causes people to seek out coping mechanisms that are not always healthy. And, in some cases, it may even cause families to break apart.Sometimes childbirth is a coping mechanism for poverty simply because an extra set of hands means an extra chance for income. By reducing these stress markers, households can focus on the job at hand to provide for themselves, even if that means net income levels for that family may not rise in the near future.

**11. It allows people to feel like they matter.**

The feeling of receiving a credit product for the first time cannot be ignored. It's a feeling like you've made it. That you really are somebody because you've been trusted with credit. This feeling applies to everyone, even in the developed world. When a person feels like they matter, it changes who they are at a core level. Instead of focusing on how they can just survive, then begin to look for ways to thrive.This brings us back to the stress that poverty creates on people. People, when they are approved for a microloan for the first time, will often have a reaction that is similar to Steve Martin's reaction in The Jerk when he discovered his name in the phone book.And this is why Yunus feels that credit is a fundamental right. Without credit, survival is often the best possible outcome. With credit, there is hope that anything can be possible.

**12. It offers significant economic gains even if income levels remain the same.**

The gains from participation in a microfinance program including access to better nutrition, higher levels of consumption, and consumption smoothing. There is also an unmeasurable effect which occurs when women are empowered to do something in their society when they might not normally be allowed to do so. As spending occurs, these benefits also extend outward to those who may not be participating in the program so that the entire community benefits.The most important weakness of microfinance is that the effects of raising income levels for the poor can often be questionable. Although it raises the possibility of income accumulation and savings, microfinance products also raise the possibility of creating a further indebtedness that may potentially extend the cycles of poverty for an infinite period of time.Although some may look at consumption in a negative view, those who have gone without for so long will see improved consumption as a sign that things are getting better. Consumption smoothing allows an entire community to realize the benefits that microfinance can provide.

**Challenges of Microfinance:**

There are also many social and financial challenges for microfinance initiatives. For example, more articulate and better-off community members may cheat poorer or less-educated neighbours. This may occur intentionally or inadvertently through loosely run organizations. As a result, many microfinance initiatives require a large amount of social capital or trust in order to work effectively. The ability of poorer people to save may also fluctuate over time as unexpected costs may take priority which could result in them being able to save little or nothing some weeks. Rates of inflation may cause funds to lose their value, thus financially harming the saver and not benefiting the collector.

**Impact and criticism:** Most criticisms of microfinance have actually been criticisms of microcredit. Criticism focuses on the impact on poverty, the level of interest rates, high profits, over indebtedness and suicides. Other criticism include the role of foreign donors and working conditions in companies affiliated to microfinance institutions, particularly in Bangladesh.

**Impact:**

The impact of microcredit is a subject of much controversy. Proponents state that it reduces poverty through higher employment and higher incomes. This is expected to lead to improved nutrition and improved education of the borrowers' children. Some argue that microcredit empowers women. In the US and Canada, it is argued that microcredit helps recipients to graduate from welfare programs.

Critics say that microcredit has not increased incomes, but has driven poor households into a debt trap, in some cases even leading to suicide. They add that the money from loans is often used for durable consumer goods or consumption instead of being used for productive investments, that it fails to empower women, and that it has not improved health or education. Moreover, as the access to micro-loans is widespread, borrowers tend to acquire several loans from different companies, making it nearly impossible to pay the debt back.As a result of such tragic events, microfinance institutions in India have agreed on setting an interest rate ceiling of 15 percent.This is important because microfinance loan recipients have a higher level of security in repaying the loans and a lower level of risk in failing to repay them.

The available evidence indicates that in many cases microcredit has facilitated the creation and the growth of businesses. It has often generated self-employment, but it has not necessarily increased incomes after interest payments. In some cases it has driven borrowers into debt traps.There is no evidence that microcredit has empowered women. In short, microcredit has achieved much less than what its proponents said it would achieve, but its negative impacts have not been as drastic as some critics have argued. Microcredit is just one factor influencing the success of small businesses, whose success is influenced to a much larger extent by how much an economy or a particular market grows. For example, local competition in the area of lack of a domestic markets for certain goods can influence how successful small businesses who receive microcredit are.Unintended consequences of microfinance include informal intermediaton: That is, some entrepreneurial borrowers become informal intermediaries between microfinance initiatives and poorer micro-entrepreneurs. Those who more easily qualify for microfinance split loans into smaller credit to even poorer borrowers.

**Conclusion:**

The present paper highlights the micro-finance & evaluates the position of micro-finance. The concept of microfinance is not new in India. Traditionally, people have saved with and taken small loans from individuals and groups within the context of self-help to start businesses or farming ventures. Majority of poor are excluded from financial services. Micro finance is a programme to support the poor rural people to pay its debt and maintain social and economic status in the villages.Micro-finance is an important tool for improving the standard of living of poor. Microfinance plays an imported role in the developing country of the world. In India it significantly contributes in the developing of employment, output and improving the livings of people especially in rural. Microfinance is for social upliftment as well as for the development of rural backward area.

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