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Research Paper

Microfinance and Small Business Development in India:A Conceptual Framework

Shoket Hussain
Ph.D. Research Scholar
Department of History
Nagina Kousser Ph.D. Research Scholar
Department of Economics, University of Jammu

ABSTRACT
The founders of the microcredit movement in the 1970s (Muhammad Yunus and Al Whittaker), have tested practices and built institutions designed to bring the kinds of opportunities and risk-management tools that financial services can provide to the doorsteps of poor people. This study explored the roles of these micro finance banks and institutions on small and medium enterprises as well as the extent to which the small businesses have benefited from the credit scheme of microfinance banks. This study advocates the recapitalization of microfinance banks to enhance their capacity to support small business growth and expansion and also to bring to the knowledge of the management of microfinance banks and institutions the impact of the use of collaterals as a condition for granting credit to small businesses. Of the 2.6 crore enterprises in India, approximately 5% have access to formal finance. The total demand for finance is estimated to be INR 32, 50,000 crore with 80% of the demand originating from the informal sector. The share of formal finance to the sector is INR 7, 00,000 crore. A further analysis reveals that the total institutional credit to enterprises having capital investment up to Rs 25 lakh is approximately INR 2, 30,000 crore as per the SIDBI report in 2012 and IFC report in 2012. About 90% of the institutional credit has come from scheduled commercial banks with other players being regional rural banks and urban cooperative banks. An estimated 67% of enterprises remain untouched by the formal financial sector.
KEYWORDS: *Microcredit, risk-management, Small business, Informal finance, Collaterals*

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I. INTRODUCTION

Microfinance is a source of financial services for entrepreneurs and small businesses that do not have easy access to banking and related services. The main objective of microfinance is to assist the poor to overcome the poverty and thus help in economic development. Microfinance is not only giving micro credit but it includes wide range of services like insurance, savings, remittance and also non-financial services like training, counselling etc. Micro-Enterprises sector has been recognized as an important pillar of economic growth all over the world. The sector is characterized by low investment requirement and operational flexibility. Micro-Enterprises play a very important role in the development of country because of its innovative entrepreneurial spirit. In many developing economies including India, Small and medium enterprises (SMEs) plays a crucial role in employment creation and income generation. What are the key factors influencing Micro-Enterprise to become small than medium enterprise and hence large enterprises? It is Microfinance. Microfinance is an important tool to promote business development. Researches shows that in Bangladesh more than 15 million families are benefited from small loans and other financial products such as micro-savings and micro-insurance and about 40% of the overall reduction of rural poverty in recent years has been due to microfinance provided to Micro-Enterprises. The fact that in India, the national bodies like Small Industries Development Bank of India (SIDBI) and National Bank for Agriculture and Rural Development (NABARD) are devoting significant time, energy and financial resources on microfinance, is an indication of the reckoning of this sector. But still Micro-Enterprises continue to fail from the problems that microfinance institutions claim to offer solutions to. A gap exists in finding out the effect of Microfinance institutions on the growth and development SMEs. In light of this the main aim of the research is to establish the effect of microfinance institutions on the growth and development of small and medium enterprises. The study was guided by the objective; to find out the role of MFIs financing on business expansion, sales volume, profit and physical assets of the SMEs.

Definitional Aspect of Micro, Small and Medium Enterprises (MSMEs) the definition of Small Scale Industries has undergone changes for many times. The main criterion for definition was mainly the investment level and number of employees. The chart below shows the changing pattern of SSI definition

Manufacturing sector Enterprises investment in plant and machinery	
Micro Enterprises	Does not exceed twenty five lakh rupees
Small enterprises	More than twenty five Lakh rupees but does not exceed five crore rupees
Medium enterprises	More than five crore rupees but does not exceed the crore rupees
Services sector enterprises investment in equipment	
Micro enterprises	Does not exceed ten lakh rupees
Small enterprises	More than ten lakh rupees but does not exceed but does not exceed two crore
Medium enterprises	More than two crore rupees but does not exceed five crore rupees

Source: MSMED Act 2006

Financial inclusion

Financial inclusion is the delivery of financial services at affordable costs to vast sections of disadvantaged and low income groups (for example "no frill accounts"). Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost (The Committee on Financial Inclusion, Chairman: Dr. C. Rangarajan). The Government of India and the Reserve Bank of India have been making continuous efforts to promote financial inclusion. The fundamental objective of promoting financial inclusion is to reach to the financially backward Indian population. RBI has adopted a bank-led model for achieving financial inclusion and removed all regulatory bottle necks in achieving greater financial inclusion in the country. The banking industry has shown tremendous growth during the last few decades. Despite the progress and improved profitability of banks, Indian banks have not been able to include vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services (Thorat, 2007). The share of rural credit in the total credit disbursement by commercial banks, which grew from 3.5 to 15 percent from 1971 to 1991, declined again to 11 percent in 1998 (Sa-Dhan, 2004). The fall in the availability of credit from formal financial system led to the emergence of informal sources as well as SHGs and MFIs (Fisher and Sriram, 2002). At this juncture Micro Finance services are doing well in bringing excluded population to the main stream of formal banking system. 3. MICRO CREDIT Credit is one of the critical inputs for economic development. Its timely availability in the right quantity and at an affordable cost goes a long way in contributing to the well-being of the people especially in the lower rungs of society. Much of the current interest in microcredit stems from the Microcredit Summit (2-4 February 1997), and the activities that went into organizing the event.Microcredit programmes extend small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families‟. Micro Credit is defined as provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards. Microcredit is the extension of small loans to entrepreneurs too poor to qualify for traditional bank loans. It has proven an effective and popular measure in the on-going struggle against poverty, enabling those without access to lending institutions to borrow at bank rates, and start small business.

Microfinance

Microfinance refers to an array of financial services to low-income individuals or to those who do not have access to typical banking services. As per the RBI master circular on micro credit, Micro Finance is defined as a provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their living standards. Microfinance provides the access to financial services to the low-income individuals or to small and medium size enterprises. Microfinance is the supply of loans, savings and other basic financial services to the poor.

Microloan is given for a variety of purposes, frequently for microenterprise development. As microfinance institutions focuses on the low-income group, it often uses non-traditional methodologies, such as group lending or other forms of collateral not employed by the formal financial sector. Microfinance is not a new concept. Small microcredit operations have existed since the mid-1700s. However, the pioneering of modern microfinance is often credited to Dr. Mohammad Yunus, who began experimenting with lending to poor women in the village of Jobra, Bangladesh during his tenure as a professor of economics at Chittagong University in the 1970s. In 1983 he formed the Grameen Bank, meaning „village bank" founded on principles of trust and solidarity and won the Nobel Peace Prize in 2006. Since then, innovation in microfinance has continued and providers of financial services to the poor continue to evolve. Today, the World Bank estimates that about 160 million people in developing countries are served by microfinance. As per Grameen Bank, Microfinance is a source of financial services for small businesses and entrepreneurs lacking access to banking and related services of bank. The two main mechanisms for the delivery of financial services to such clients are: (i) Relationship-based banking for small businesses and individual entrepreneurs. (ii) Group-based models, where some entrepreneurs come together to apply for loans and other services as a group. 5.

Microfinance Institutions

MFIs are those institutions which have microfinance as their main operation. The main aim of MFIs is to offer microfinance service. The proposed Microfinance Services Regulation Bill defines Microfinance Institutions as an organisation or association of individuals including the following if it is established for the purpose of carrying on the business of extending microfinance services: i. a society registered under the Societies Registration Act, 1860, ii. A trust created under the Indian Trust Act,1880 or public trust registered under any State enactment governing trust or public, religious or charitable purposes, iii. a cooperative society / mutual benefit society / mutually aided society registered under any State enactment relating to such societies or any multistate cooperative society registered under the Multi State Cooperative Societies Act, 2002 but not including: a cooperative bank as defined in clause (cc a cooperative society engaged in agricultural operations or industrial activity or purchase or sale of any goods and services".

In India microfinance operates through two channels:

a. SHG – Bank Linkage Programme (SBLP)

b. Micro Finance Institutions (MFIs)

a. SHG – Bank Linkage Programme This is the bank-led microfinance channel which was initiated by NABARD as an Action Research Project in 1989. A self-help group (SHG) is a small group usually composed of 10–20 local women or men. A mixed group is generally not preferred. Members make small savings contributions in the group periodically over a few months until there is enough capital in the group to begin lending. Once the SHGs are settled, it gets linked to banks via NGOs, for opening savings account and for other credit requirements. Banks lend to SHGs after assessing their credit worthiness b. Micro Finance Institutions (MFIs) Micro Finance Institutions (MFIs) plays a significant role in facilitating financial inclusion and thus helping the poor with finance. A microfinance institution (MFI) is an organization that provides microfinance services. It ranges from small non-profit organizations to larger banks) of section 5 of the Banking Regulation

SHGs-BLP

There are three models of linking SHGs with bank:

MODEL1 provide all assistance to SHGs directly without any intervention of formal agencies

MODEL2: provides all assistance to SHGs directly with facilitation by NGOS and others formal agencies.

MODEL3: provides all assistance through NGOs as facilitator and financing agency

SHG - Bank Linkage Programme is a strong intervention in economic enablement and financial inclusion for the bottom of the pyramid. A proven platform initially conceived for increasing the outreach of banking services among the poor has since graduated to a programme for promotion of livelihoods and poverty alleviation. All the major parameters viz. the number of SHGs with savings bank accounts, amount of credit disbursed during the year, the bank loans outstanding as well as the quantum of savings outstanding had shown positive growth during the past three years

Scope of the Study

In the context of necessity of credit for the growth of Micro-Enterprises and realizing the importance of Microfinance Institutions, an attempt is made to study the role of Microfinance Institutions on the growth and development of Micro-Enterprises.

II. LITERATURE REVIEW

Many researchers have studied Microfinance and Micro-Enterprises from different views and in different contexts. The following are very interesting and useful for our research.

Abhinavvipanand chauhan (2015) in India, the beginning of microfinance movement could be traced to Self Help Group (SHG) – Bank Linkage Programme (SBLP) started as a pilot project in 1992 by NABARD. This programme proved to be very successful and has also developed as the most popular model of microfinance in India.

Bhandari Amit K, and Kundru A (2014) Microfinance, risk taking behaviour and rural livelihood are the three dominating issues in the rural financial landscape. Inadequate access to financial services is considered to be one of the main reasons behind inadequate economic opportunity and poverty in rural India. Microfinance has played a significant role in shaping the rural financial scenario.

Bayyoud M* and Sayyad N (2016) small enterprises are one of the most important key elements in achieving economic development in all countries of the world where it accounts for the highest percentage among all kinds of economic projects of all sizes.

Jane Annre et.al (2014) revealed that the key challenges hindering micro and small credit enterprises are high cost of repayment, unwillingness to act as guarantors and strict collateral requirements etc.

Ghosh (2013) leading MFIs did not spread their lending out, but rather tended to concentrate in certain geographical areas, thereby generating saturation and excess competition in the local market.

Objectives

To examine the role and importance of Microfinance in promoting small business in India
To ascertain, the constraints faced by the microfinance in promoting small business
To draw the suggestive measure to overcome these challenges

Research Methodology

This is a descriptive research paper based on secondary data. Data have been collected through books, various websites, magazines, newspapers, and publications of recent research papers available in different websites, Research Articles, Research Journals, E-Journals, RBI Report, and Report of NABARD etc

Challenges and Constraints faced by Microfinance in Promoting Small Business India

Investment valuation is a key capability for an MIV or an MFI. Due to the nature of the markets in which MFIs and MIVs operate, which are usually developing markets with limited market activity, gaining recent market data for valuation purposes is very challenging. Without proper, diligent, consistent and reliable valuation procedures, management does not have the level of quality information that they need to be able to steer the entity or make investment decisions. Low quality of information may lead to losing business, and high quality levels may lead to additional business.

As microfinance entities grow, their growth needs lead to capitalization and funding challenges. One of the options to accelerate growth of an MFI is doing an initial public offering (IPO). Leading a fast-growth company through an IPO can be an intense and emotional ride, but the need for hard work doesn't end there. Life is very different for newly listed companies. In our view, there are three key challenges that companies typically face in the post-IPO period. They are: Working with a larger and more diverse body of investor's .Delivering on your promises. Maintaining the pace of growth

Like any other industry, microfinance is faced with financial, operational, compliance and strategic risks. Given the nature of the markets in which MFIs and MIVs operate, there are some risks, such as the risk of over-indebtedness that are more prevalent and inherent to microfinance. In addition, due to the increasing use of mobile technology, the industry is faced with data security issues and risks related to cyber-crime.

Over the last few years, the microfinance sector has suffered relevant cases of microfinance products miss-selling that have often threatened the confidence in the sector. The anti-money laundering and combating financing of terrorism (AML/CFT) requirements could also represent a critical factor when facing current challenges, such as branchless client on-boarding. In the case of regulated MFIs, these and similar issues often result in the intervention of the regulator, including severe government supervision measures. Along with managing regulatory involvement, MFIs facing a business crisis have to address customer and related complaints as well as general public opinion criticism.MFIs face a challenge to strike a balance between social and business goals. sIndia's Microfinance sector is fragmented, having more than 3,000 MFIs NGO- MFIs present.

Remedial Measures:

To provide loans at concessional rate of interest so that small business can develop and avail the benefits of loan facilities.

Constant training and development is required for the staff in delivering specialized banking services like microfinance. They need to be trained in providing technology-based products and services to render the state-of-the art services to their customers.

Customers of microfinance products being primarily the rural poor, they also deserve training on modern banking services in order to avail high-end banking products and services conveniently. They should be trained adequately as to how to use of ATMs, use mobile-based services etc. Mass awareness camps to educate customers about modern banking practices are organized periodically at suitable locations for the above purpose.

Specialized financial intermediaries like Co-ops and RRBs should preferably have maximum of employees with rural background so that they can understand their customers well than others. Only they can sense the pulse of the rural market for microfinance. Besides, better working environment and interpersonal relationships need to be fostered to improve the performance and productivity of the employees on a regular basis.

Co-ops and RRBs should ensure complete adherence to the directives of the regulatory bodies like the RBI and NABARD on an ongoing basis.

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