The Role of Microfinance in the Rural Development of India

Renson John
Assistant Professor, Post Graduate and Research Department of Commerce Christ College (Autonomous), Irinjalakuda

***Abstract*—Formal financial institutions failed to reach the poorer sections of the rural society due to informational asymmetry, moral hazard and enforcement problems. The necessity of having alternative rural credit systems which will solve the problems of rural credit institutions is clearly warranted. Micro finance institutions are seen to have characteristics that help solve the problems moral hazard and adverse selection, which other institutions failed to do. Group lending, peer monitoring and joint liability systems solve the adverse selection and moral hazard issues associated with rural credit markets. The objective of the study is to examine the success of the micro finance as an institution that solves the problems of moral hazard and adverse selection, which are the existing problems of rural credit institutions. Micro finance is emerged as a powerful instrument for providing basic financial facilities to the rural poor, women, (in rural, semi-urban areas) small and marginal farmers, rural artisans and economically weaker sections. Micro-finance is defined as the provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas so as to enable them to raise their income levels and improve their living standard. In underdeveloped regions fighting with higher presser of population severe poverty and socioeconomic disparities, rural economy plays crucial role for providing livelihood facilities. This study is mainly focuses on the role of microfinance in the rural development of India.**

***Index Terms*—Rural Credit, Agriculture, SHG-Bank Linkage Programme, MFIs**

I. INTRODUCTION

The responsibility of meeting the credit needs in the rural areas of India was entrusted primarily with the cooperative banking sector until about the mid-1960s. As the technological developments in the agricultural sector started gathering momentum, it was expected that commercial banks would play an increasing role in the rural credit market through branch expansion and direct lending. One of the major objectives of the nationalization of Indian commercial banks was the improvement of the flow of formal institutional credit into rural households, especially to the poor, thus relieving them of the burden of usurious debt.

The overriding objective of nationalization was the taking of banking to the „masses". The government envisaged that 40 percent of the total credit of the nationalized banks/commercial banks should be channelized to priority sectors (of which 18 percent was for agriculture and ten percent for weaker sections), groups or regions to support activities that were either considered to be socially beneficial or inherently risky and borrower groups that were likely to be marginalized in the credit markets, at lower rates of interest. This was an important step in the direction of asserting the developmental role of banks.

These measures had a strong impact on rural economy. The vast branch expansion of nationalized banks helped the people in remotest areas to have access to financial services. The growth and extension of rural credit displaced village moneylenders to a significant extent and led to modest increases in aggregate crop output, sharp increases in the use of fertilizers and in investments in physical capital like tractors, pump sets and animal stocks. A substantial positive effect is seen in non-farm employment and output also. Although the banking system has experienced phenomenal growth in terms of geographical spread, deposit mobilization and disbursal of credit in rural areas after nationalization, bank credit remains by and large,

Financial Inclusion in Rural India: The role of Microfinance as a Tool inaccessible to the poor. The poor both in rural and urban areas do not have the necessary capabilities to
approach and negotiate with formal financial institutions. through self-employment is ignored by the formal financial sector.
Further, the rural credit system entrapped by the twin problems of high transaction cost and poor repayment performance reduces the profitability of rural branches of nationalized banks. The incompetence of management of individual banks also increased the non-viability of the rural credit delivery system. The creditworthiness criteria adopted by institutional credit are alienating small farmers from borrowing as lending is closely linked to the landholding status of the borrower. The formal credit institutions neglected consumption needs of the poor and emphasized only on production credit. The spread of the system has been uneven across regions and wealth groups. In recent periods, banking sector witnessed tremendous changes in terms of technological advancements, internet banking, online money transfers, etc. But it is a reality that access to such technology is restricted only to certain segments of the society. Indeed, some trends, such as increasingly sophisticated customer segmentation technology have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle-income population and a significantly large section of the population who lack access to even the most basic banking services.

II. STATEMENT OF THE PROBLEM

Financial Inclusion is important for improving the living conditions of poor farmers, artisans and rural non-farm enterprises. Financial Exclusion, in terms of lack of access to credit from formal institutions, is high for small and marginal farmers. Apart from formal banking channels, the role of MFIs, NABARD, Self Help Group movement is important to improve Financial Inclusion. Banks need to take bold decisions and reach out to rural India with strategies and Business models which are beyond the realm of conventional thinking. They need to identify the emerging opportunities in rural India and innovate with low-cost platforms, lean branch models, low-cost subsidiaries, cost effective technologies, leverage on Aadhar, shared Infrastructure and build collaborative business models to serve in Rural India.

III. OBJECTIVES OF THE STUDY

The objectives of the study are the following
3.1 To study the extent of progress made by microfinance in rural India
3.2. To look into the challenges ahead for microfinance in India.
3.3 To examine the nature and problem of rural credit.
3.4 To explore relationship between rural credit and microfinance.
3.5 To analyze the alternative Sources of Rural credit

IV. METHODOLOGY

The present study explores the relationship between rural credit and microfinance in India. This is a source of alternative instate of informal credit sources of rural India. The present study provides evidence of emergence of micro finance as alternative sources of rural credit over a period of time because it is a blend of formal and informal credit. This study based on the secondary data provided by the different sources like Mix Market, NABARD, RBI and different govt. India agency like Ministry of finance, planning commission.

V. NATURE AND PROBLEMS OF RURAL CREDIT

There are three aspects of analyzing the nature and problems of rural credit markets: a) It is important to highlight the features of *existing* credit markets and their function in order to bring out the inadequacies in terms of performance. b) Secondly, it is crucial to identify the *type of credit* that is typically asked for by the rural population in order to understand whether the existing credit markets cover the needs and, more importantly, whether the new institutions of micro-finance help in bridging the gaps, if they exist, in catering to the diverse needs of the rural poor. c) There are severe problems of adverse selection (on part of Lenders) and Moral hazard (on part of borrowers) in rural credit markets that pose problems to formal institutions in lending money to rural areas.

VI. SOURCES OF RURAL CREDIT

The availability of credit and generation of savings has been recognized as an essential element in the rural development strategy. Credit plays a crucial role in the modernizations of agriculture but its role of fight against rural poverty has seldom been recognized. Financial institutions in developing countries, whether public and private have shunned rural credit for various reasons such as opportunity costs and low financial credibility. Further rural financial services have mostly been controlled by rich farmers, who are able to use their large endowment base and influence within the local power structure to secure loans at high advantaged, terms. Credit policies are also generally concentrated on land based agricultural production programmes, neglecting off-far in activities in which the poor are mainly engaged. The rural poor men and women, landless people artisans' agricultural laborers, and small fishermen have mostly been excluded from the financial services either because they were not available (collateral and procedural requirements rendered them inaccessible) or simply because they were not conceded creditworthy. The erroneous view is that the poor do not have any resources, do not save, and that they cannot invest in view of immediate consumption needs, and that they are ignorant of the basic principles of sound money management.

VII. DISCUSSION OF RESULTS

The process of financial inclusion is an attempt to bring within the ambit of the organized financial system the weaker and vulnerable sections of society. Financial inclusion can be defined as the delivery of credit and other financial service at an affordable cost to the vast sections of the disadvantaged and low-income groups. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include, within its ambit, people with low incomes. Through graduated credit, attempts must be made to lift the poor so that they come out of poverty. Financial inclusion may, therefore, be defined as the process of enabling access to timely and adequate credit and other financial service by vulnerable groups, such as weaker sections and low-income groups at affordable cost. The target for National Rural Financial Inclusion Plan (NRFIP) is to provide access to comprehensive financial services to at least 50% (55.77 million) of the excluded rural cultivator and noncultivation households, across different States by 2012 through" rural/ semi urban branches of Commercial Banks and Regional Rural Banks.

7.1 The Extent of Financial Exclusion in Rural India

Based on the All-Indian Debt Investment Survey 2002, 111.5 million households had no access to formal credit. It also showed that 17 million households were indebted to moneylenders. The Arjun Sengupta Report on financing enterprises in the unorganized sector has pointed out that only 2.4 million out of 58 million units in this sector (with investment of less than Rs 25000) have got credit from commercial banks. The AIDIS 2002 also showed that lower the asset class or income, higher the degree of exclusion. These findings are corroborated by Invest India Incomes and Savings Survey (2007). The survey showed that 32.8% of households had borrowed from institutional sources and 67.2 % had borrowed from non-institutional sources. The survey also found that 70 per cent of earners in the annual income bracket of more than Rs.400,000 borrowed from institutional sources as compared with only 27.5 per cent in the case of earners in the income bracket of less than Rs.50,000.

7.2 Microfinance and Financial Inclusion

Since formal credit institutions rarely lend to the poor, special institutional arrangements become necessary to extend credit to those who have no collateral to offer. Microfinance, by providing small loans and savings facilities to those who have been excluded from commercial financial services, has been promoted as a key strategy for reducing poverty in all its forms by agencies all over the world. Microcredit has been defined as "programmes that provide credit for self-employment and other financial and business services (including savings and technical assistance) to very poor persons" (Micro Credit Summit, 1997). Nowadays, microfinance represents something more than microcredit - it also refers to savings, insurance, pawns and remittances, in sum to a much wider range of financial services (Tankha, 1999). In most cases, microcredit programmes offer a combination of services and resources to their clients in addition to usual credit for self-employment. Also, this is an effort to provide a bridge between formal financial markets and the informal groups in the formal microfinance initiatives.

The basic idea of microfinance is that poor people are ready and are willing to pull themselves out of poverty if given access to economic inputs. The need for informality in credit delivery and easy access is demonstrated by the fact that Self Help Groups (SHGs) and Microfinance Institutions (MFIs) constitute the fastest growing segment in recent years in reaching out to small borrowers. Micro-finance is a new development in which Indian institutions have acquired considerable expertise and where up-scaling holds great promise both

to expand the nature of financial services offered to micro enterprises and to make these the springboard for entrepreneurial development. (Planning Commission, 2006)

The SHG movement is bringing about a profound transformation in rural areas of India. MFIs play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele. It is roughly estimated that there are about 1,000 NGO-MFIs and more than 20 Company facilitating the activities in all over India. There are today over 22 lakh such groups linked with banks. The objective of the country is to enroll at least 50% of all rural women in India as members of SHGs over the next five years and link these SHGs to banks.

7.3 Progress of Microfinance in India

The institutions which engage in microfinance services in India follow three types of approaches namely

i. The Grameen Bank approach.

ii. The Cooperative Societies (which are members of a cooperative bank) approach.

iii. The SHG Programme approach.

In the four years between 2003 and 2007, small borrower bank accounts (credit) i.e. up to Rs 25,000 increased marginally from 36.9 million to 38.6 million, while SHGs‟‟ borrowing members grew from 10 million to 40.5 million and MFIs‟‟ borrowers grew from 1.1 million to 8 million. In 2007-08, MFIs have added 6 million clients increasing their outreach to 14 million as per data brought out by Sa Daan.

An innovative scheme in rural delivery system launched by NABARD is the linking of SHGs of the poor with banks and bulk lending through NGOs. NABARD considers SHGs a pre-microenterprise stage for a majority of the rural population. The linkage project envisages active involvement of NGOs who play a crucial role in formation, nurturing, stabilizing and guiding the SHGs into cohesive and dynamic groups inculcating the habits of thrifts and credit management and ultimately establishing linkage with the banks. Under the SHG-bank linkage programme, three linkage models have broadly emerged. Under the first model, banks directly link SHGs without the intervention of the NGOs. In the second model, banks provide credit to SHGs and NGOs act as Self-Help Promoting Institutions (SHPIs). Under the third model, NGOs act both as SHPIs and financial intermediaries for channelizing credit from banks to SHGs.

The SHG-Bank Linkage Programme implemented by commercial banks, RRBs and cooperative banks has emerged as the major micro- finance programme in the country. Under the SHG-Bank Linkage Programme, as on March 31, 2009, 61,21,147 SHGs held savings bank accounts with total savings of Rs 5,545.62 crore as against 50,09,794 SHGs with savings of Rs 3,785.39 crore as on March 31, 2008. Thus, more than 8.06 crore poor households were associated with banking agencies under the SHG-Bank Linkage Programme.

7.4 Challenges Ahead for Microfinance in India

An evaluation of SHGs carried out by the regional offices (ROs) of the Reserve Bank revealed that there was scope for improvement in the area of maintenance of books of accounts. It also brought out that rotation of group leaders was generally not followed by SHGs. However, other best practices like strict adherence to attendance of group meetings, recording minutes of the meetings and prompt repayment of bank loans were being followed. The momentum of growth in the micro-finance sector has brought into focus the importance of regulating the sector to function in an efficient and orderly manner. There would be need for greater transparency in their functioning and for facilitating their reach to un-banked population of the country

Interest rates in the microfinance sector have to be significantly higher than in the banking sector reflecting the much higher cost of doing business. This attracts criticism but it is important to remember that most microfinance institutions charge rates which are much lower than rates charged by money lenders. Borrowers stand to benefit from the experience of micro-finance institutions as these provide competition to money lenders. (Planning Commission, 2006)

VIII. CONCLUSION

Micro Finance has emerged as a powerful instrument for providing basic financial facilities to the rural poor, women, small and marginal farmers. The introduction of Micro finance programme increased the borrowing options to the rural poor and it is supposed to work as a weapon to alleviate poverty and to save the rural poor from the money lenders. Informal sector lenders remain a strong presence in rural India in terms of providing credit facilities in rural India. Farmers and rural poor borrowings from Money lenders and other informal sources of rural credit still significant this source some extent i.e. 77 percent to 32 percent. In this situation micro finance has emerged as an alternative source of rural credit, microfinance programmes have provided all kinds of banking services, it includes loans, thrifts and insurance services. Sometimes it is working more than financial institutions. In addition to providing financial services MFIs typically provide information related to basic education, health, hygiene, child immunization, disease prevention and environment surely one cannot deny the role of microfinance in poverty reduction as it raises income and consumption of poor households. Around the world 128 million people were received microcredit. The growth of microfinance borrowers in the context of India consists of two dominated models SBLP and MFIs increases from 48.0 to 93.9 million in between 2006-2011years. Major findings of this study explore the relationship between rural credit and microfinance instead of non-institutional sources of rural credit. The impact of microfinance on burden of rural debt is declined sharply, especially moneylenders and other non-institutional contribution in terms of lending to farmers, poor and women borrowings is going to downwards. Well managed and regulated microfinance programmes (particularly rate of interest, forced recovery of microcredit loans) augmented rural sector employment, productivity of non-agriculture sector, establishment of MSMEs, empowerment of women in socioeconomic aspects, it enhances health and educational facilities. Another important impact of microfinance programmes is that reduction of income and consumption disparities, especially vulnerable sections of the society will get the benefits from collateral or guarantee free. Microfinance programmes implies that the consumption pattern, it encourages from non-productivity expenditure to productive expenditure because of timely repayments of loans.

REFERENCES

[1] Directorate of Economics and Statistics, *Agricultural Statistics at a Glance*, (Annual issues from 1970 to 2008) Ministry of Agriculture and Cooperation, Govt. of India, New Delhi. GoI (2004) Ministry of Finance, Government of India, New Delhi.

[2] Golait, Ramesh (2007) Current issues in agriculture credit in India: An assessment, *Reserve Bank of India Occasional Papers,* 28, No. 1.

[3] Kumar, Anjani, Singh, Dhiraj K. and Kumar, Prabhat (2007) Performance of rural credit and factors affecting the choice of credit sources, *Indian Journal of Agricultural Economics.* Mohan, Rakesh (2004) Agricultural credit in India: Status, issues and future agenda, *Reserve Bank of India Bulletin,* November.

[4] NABARD *Databank* (various issues) National Bank for Agriculture and Rural Development, Mumbai.

[5] NSSO (2003) *Unit Level Data of NSSO, 59th Round Situation Assessment Survey of Farmers*, Ministry of Statistics and Programme Implementation, Govt. of India, New Delhi.

[6] Reserve Bank of India (2008a) *Handbook of Statistics on the Indian Economy*, 2007-08, Mumbai.
[7] Reserve Bank of India (2008b) *Report on Currency and Finance*, 2007-08, Mumbai.