Journal of Advances and Scholarly Researches in Allied Education

Vol. VI, Issue No. XI, July-2013, ISSN 2230-7540

ROLE OF MICRO FINANCE IN RURAL DEVELOPMENT: A STUDY

AN INTERNATIONALLY INDEXED PEER REVIEWED & REFEREED JOURNAL

Journal of Advances and Scholarly Researches in Allied Education
Vol. VI, Issue No. XI, July-2013, ISSN 2230-7540

Role of Micro Finance in Rural Development: A Study

Ashutosh Shukla*

Independent Researcher, Allahabad

Abstract* – *India stands among one of the fastest developing economy among the category of developing nations, and to sustain this pace of development the role of Rural Development cannot be overlooked, and one of the core ingredient of rural development is "Micro Finance" as no economy can grow without the active role of financing, and due to lack of formal sources of financing in rural areas, the role of 'Micro Finance" has increased by leaps and bounds in the last decade. In light of this the present paper deals with the emergence, mechanism, role, and intensity of microfinance in context to rural areas, and the role played by SHG's and MFI's in this context.

Key Words: Micro Finance, SHG's, MFI's, Mechanism, Intensity.

---------------------------------X---------------------------------

INTRODUCTION

It is well debated that in developing countries both formal and informal financial sectors have failed to serve the poor at required level. Micro Finance refers to the stipulation of financial services for both credit and deposits that are provided to the people who are living with the poverty. It is the provision of thrift, credit and other financial services and products of very small amounts to the poor for enabling them to raise their income levels and improve their living standards. In Indian context the nationalization of banks in 1969 evolved a concept of "*mass banking*" from "*class banking*", and 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 (Bell, 1990) 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 (Binswanger and Khandker, 1992).

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, inaccessible to the poor. 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 (Analyst, 1993). Rajasekhar (1994) concluded that there is widespread belief that the poor are unbankable. There are also internal problems such as absence of linkages of credit with marketing, investment credit having no provision for working capital. Inadequate staff and managerial deficiencies within the banking system have also been causing problems.

ORIGIN OF MICRO FINANCE IN INDIA

The beginning of Micro Finance movement in India could be traced to the self-help groups SHG-Bank Linkage Programme (SBLP) started as a pilot project in 1992 by National Bank for Agricultural and Rural Development (NABARD). This programme not only proved to be very successful, but also emerged as the most popular method of micro fiancé in India. Other approaches like Micro Finance Institutions (MFIs) also emerged subsequently in the country. Micro Finance programme has a significant role to play in Indian economy for boosting micro entrepreneurial activities for creating productions assets coupled with employment generation (M.A.Lokhnade, 2009). According to Rajesh Kumar Shastri (2009) "the scheme of microfinance has been found as an effective instrument for lifting the poor above the level of poverty by providing them increased self-employment opportunities and making them credit worthy". Reeta Rautela, Gaurao Pant and Other (2011) opined that "microfinance is a powerful tool for poverty alleviation and development. In order to declare microfinance success in India, not only do tens of millions of more people need to be reached but those services must have a transformational impact on their lives and those of their family members. For that considerable work and continuous efforts are needed to diversity the service of funding for microfinance to attract more foreign investments for well-established microfinance institutions (MFIs), to use all the possible channels to serve more rural and urban poor, to develop its staff as more productive and professional to make it more poverty- focused and profitable". Dadhich C.L.(2001) analyzed that "properly designed and effectively implemented microfinance can be a means not only to alleviate poverty and empower women but also be a viable economic and financial proportion. However, there is scope for further refinement".

OBJECTIVES OF THE STUDY

- ► To evaluate the intensity of Micro Finance and financial exclusion in rural India
- ► To examine the role played by microfinance at rural level rural in the case of financial inclusion.
- ► To study the reach and progress made by microfinance in rural India.
- ► To take a look at the various challenges ahead for micro finance in India.

METHODOLOGY

The methodology consists of secondary sources of data. Data published by various institutions such as National Bank for Agriculture and Rural Development (NABARD, State Level Bankers" Committee (SLBC) Government of India, Reserve Bank of India (RBI), State of the micro finance report have been taken in to consideration.

MICRO FINANCE IN INDIA

Micro credit is the most common product offering. Micro fiancé is India is synonymous with micro credit; this is because savings thrift and micro insurance constitute a miniscule segment of the micro finance space. In India most micro finance loans are in the range of Rs 5,000 to Rs 20,000 (the Development and Regulation Bill, 2007[1], defines micro finance loans as loans with amount not exceeding Rs 50,000 in aggregate per individual /small enterprise). According to an estimate that around 120 million households in India continue to face financial exclusion: this translates in to a credit demand of around Rs 1.2 trillion[2].

MFIs are the main players in the microfinance space in India their primary product is micro credit. Other players that extend micro finance services in addition their core services include banks and insurance companies agricultural and dairy co-operatives corporate organizations such as fertilizer companies and handloom houses and the postal network additionally there are specialized lenders called apex MFIs that provide both loans and capacity building support to MFIs[3].

1. The bill which envisages the the regulation of microfinance sector passed in 2011
2. Crisil Report 2009
3. NABARD,SIDBI,Rashtriya Mahila Kosh and Friends of Womens World Banking are the apex MFIs in India

Salient features of Microfinance

- ► Borrowers are from the low income group
- ► Loans are of small amount – micro loans
- ► Short duration loans
- ► Loans are offered without collaterals
- ► High frequency of repayment
- ► Loans are generally taken for income generation purpose

Micro Finance Channels

1. ***SHG –Bank Linkage -Dominant Model***

This is the bank-led microfinance channel which was initiated by NABARD in 1992. Under the SHG model the members, usually women in villages are encouraged to form groups of around 10-15. The members contribute their savings in the group periodically and from these savings small loans are provided to the members. In the later period these SHGs are provided with bank loans generally for income generation purpose. The group's members meet periodically when the new savings come in, recovery of past loans are made from the members and also new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular. The SHGs are self-sustaining and once the group becomes stable it starts working on its own with some support from NGOs

► **MODEL-I**

SHGs formed and financed by Banks –20%

► **MODEL-II**

NGOs act as Facilitators –SHGs financed directly –74%

► **MODEL-III**

SHGs financed by Banks using NGOs as Financial Intermediaries –6%

2. ***Financing through MFIs -Emerging Model***

Those institutions which have microfinance as their main operation are known as micro finance 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 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 installments and higher rate of Default

Non-Banking Financial Companies (NBFCs), Co-operative societies, Section-25 companies, Societies and Trusts, all such institutions operating in microfinance sector constitute MFIs and together they account for about 42 percent of the microfinance sector in terms of loan portfolio. The MFI channel is dominated by NBFCs which cover more than 80 percent of the total loan portfolio through the MFI channel.

► **NGO MFIs**

Societies Registration Act, 1860 or similar Provincial Acts and/or Indian Trust Act, 1882

► **Non-Profit Companies**

Section 25 of the Companies Act, 1956

► **Cooperative MFIs**

Cooperative Societies Acts of the State & Central Governments

► **Non-Banking Financial Companies (NBFCs)**

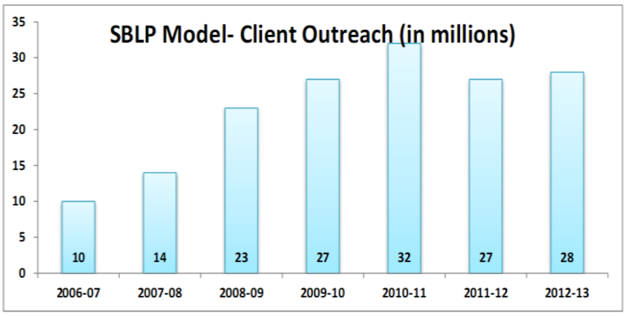
Indian Companies Act, 1956

Reserve Bank of India Act, 1934

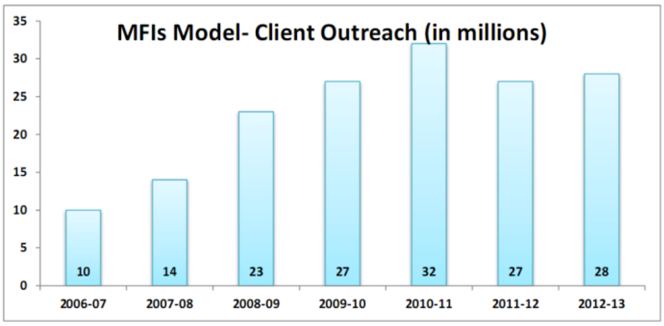
NEED FOR MICRO FINANCE

India is home to almost one third of the world's poor (surviving on an equivalent of one dollar a day). Though many central government and state government poverty alleviation programs are currently active in India, microfinance plays a major contributor to financial inclusion. In the past few decades it has helped out remarkably in eradicating poverty. Reports show that people who have taken microfinance have been able to increase their income and hence the standard of living.

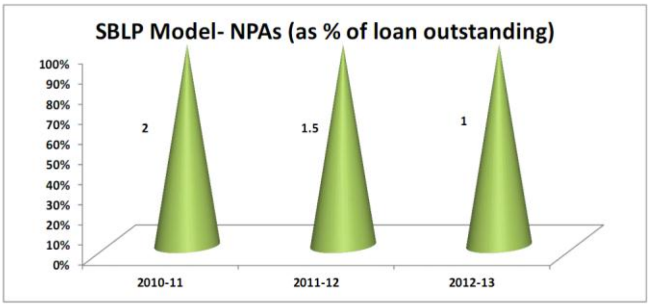
About half of the Indian population still doesn't have a savings bank account and they are deprived of all banking services. Poor also need financial services to fulfill their needs like consumption, building of assets and protection against risk. Microfinance institutions serve as a supplement to banks and in some sense a better one too. These institutions not only offer micro credit but they also provide other financial services like savings, insurance, remittance and non-financial services like individual counseling, training and support to start own business and the most importantly in a convenient way. The borrower receives all these services at her/his door step and in most cases with a repayment schedule of borrower's convenience. But all this comes at a cost and the interest rates charged by these institutions are higher than commercial banks and vary widely from 10 to 30 percent. 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



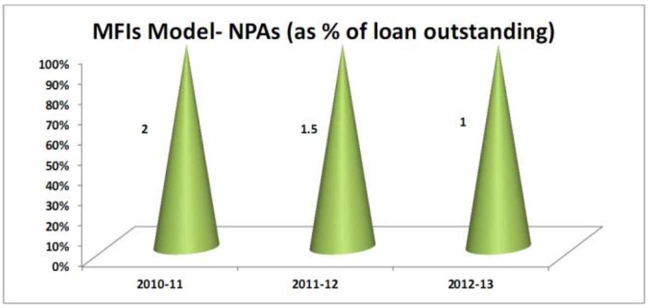
Source: Microfinance India – State of the Sector Report 2013



Source: Microfinance India – State of the Sector Report 2013



Source: NABARD: Status of the Micro Finance in India 2012-13



Source: NABARD: Status of the Micro Finance in India 2012-13

REFERENCES:

Analyst, "Myth of Non-Viability of Rural Branches", Economic And Political Weekly 28(18), 1993, pp. 853-854.

Bell, Clive (1990). "Interactions Between Institutional And Informal Credit Agencies In Rural India", The World Bank Economic Review 4(3), pp. 297-327.

Binswanger, Hans, and S. Khandker (1992). The Impact Of Formal Finance On The Rural Economy Of India, WPS 949, Agricultural And Rural Development Department.

Biz Arena (2011). MicroFinance – Current Status and Growing Concerns in India

CRISIL, India top 50 micro faience institutions.

Dadhich, C.L. (2001). "Microfinance a panacea for poverty Alleviations, Indian Journal of Agricultural Economics", Vol. 56, No. 3, pp. 420-425.

Dr. Sadyojathappa S. (2012). "Micro Finance –Self Help Groups Bank Linkage Programme (SBLP) IN INDIA", International Journal of social sciences and interdisciplinary reserachVol.1,No.6.

Lokhande, M.A. (2009). "Microfinance - Initiative in India", Kurukshetra, February 2009, pp. 16-18

MABARD Report 2013-13

Rajasekhar, D. (1994). Savings and Credit Systems Of The Poor: Some Non-Governmental Organisation (NGO) Experiences, Bangalore, NOVIB And HIVOS.

Rautela, Reeta, Gaurao Pant and Others (2011). "Microfinance - A new mantra for Rural Development", International Journal of Science, Technology and Management.

Shastri Rajesh Kumar (2009). "Microfinance and Poverty Reduction in India - A comparative study with Asian countries", African Journal of Business Management, Vol. 3 (4), pp. 136-140.

Corresponding Author

Ashutosh Shukla*

Independent Researcher, Allahabad

E-Mail – drashutosh29@gmail.com