MICRO FINANCE - A TOOL FOR RURAL DEVELOPMENT *

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Abstract

The present study highlight the role micro - finance plays in rural development by providing finance and creating employment apart from the other non-credit benefits. We focus on the challenges faced by various agencies in providing micro-finance in the contemporary context and give important policy suggestions to overcome them. By making use of secondary data, the study explores the role of micro finance in rural development and the various challenges it is facing with the help of basic statistical analysis such as figures and diagrams based on data from government reports and surveys. Both in terms of number of SHGs formed and the credit outstanding, the program has exhibited phenomenal growth. Self help group can be considered an instrument for the holistic empowerment of poor as it promotes savings, entrepreneurship, employment and women empowerment. However, there are a number of challenges faced by the micro-finance sector including the recent disintegration of SHGs. We suggest that the solution lies in creation of dedicated self help promoting institutions and supporting infrastructure for micro finance. The present study helps in appreciating the role played by micro finance in the upliftment of the rural poor. However, to reap the benefits of the program, political will is required to make the micro finance work by providing handholding support to micro finance clients as well as spending on infrastructure.

***Keywords*:** Micro-finance, SHG, rural development.

1. INTRODUCTION

India is predominantly rural with 68% population residing in rural areas. The existing inequalities between rural and urban areas in economic, social and political indicators in our country shows that the fruits of economic reforms is not shared by all sections of the society. Around 25% of the rural population lies below the poverty line as compared to 13% in urban areas. The sex ratio in rural areas is 919 as compared to 902 in urban areas. The rural - urban literacy gap is about 16.1 percentage point as per the 2011 census with literacy rate being 68.9% in rural and 84.9% in urban areas. The gap in female literacy rate is even larger with it being 59% in rural and 80% in urban areas. Moreover, the rate of migration from rural to urban areas is declining consecutively in the last three census. This is because migrants do not have access to the better paying urban job opportunities due to lack of requisite skills necessitated by rapid technological change. Therefore, there is a need to generate employment within the rural areas. Looking at these statistics, one can see that the poor living in rural areas represents the vulnerable sections of the society and special policies are required to ensure inclusive development.

One such program, the SHG Bank linkage model of micro finance was introduced by NABARD in the year 1992 which is the dominant model of micro finance in India. Both in terms of number of SHGs formed and the credit outstanding, the program has exhibited phenomenal growth. SHG is considered a tool for the holistic empowerment of the poor. It is considered to be a revolutionary program as it serves the poorest of poor who are excluded by the formal banking system. It not only pulls them out of poverty by providing finance and employment but also empowers them in various ways.

This paper is divided into the following sections. Section 2 discusses the importance of agricultural credit and explains the micro-finance program. Section 3 discusses the methodology including the sources of data and the tools used for analysis of the results. Section 4 focusses upon the role of micro finance in the provision of finance and creation of employment apart from the other non-credit benefits. Section 5 highlights the recent challenges faced by various stakeholders in providing micro-finance. Section 6 and 7 concludes the paper by giving important policy suggestions as to how to overcome these challenges and create an enabling environment for the future success of the micro-finance program.

2. Agrarian crises and the micro-finance program

Though more than half of the country's population is dependent on agriculture but its share in the GDP is only around 17%. The per capita incomes in agriculture are much lower as compared to the non-agriculture sector. What adds to the agrarian stress is t

he increasing marginalisation and fragmentation of land holdings. According to the tenth agriculture census, in the year 2015-16, small and marginal holdings constituted 86.2 % while large landholdings are only 0.57% of the total operational area.

As table 1 shows, there is a fall in the area operated in medium and large holdings between the two agriculture census, however, the area operated under marginal and small holdings shows an increase. This could have happened due to many reasons namely non-viability of large landholdings, farmer distress, indebtedness etc. Since small landholdings are uneconomical, the small and marginal farmers have to depend upon off-farm activities to supplement their household income.

Thus, there is a need to create opportunities for non-farm employment. In this respect, micro financing through the SHG model plays an important role in providing training, support and finance enabling the rural poor to become self employed.

TABLE 1:PERCENTAGE DISTRIBUTION OF AREA OPERATED BY OPERATIONAL HOLDINGS					
	MARGINAL	**SMALL**	**SEMI-MEDIUM**	**MEDIUM**	**LARGE**
2010-11	22.5	22.08	23.63	21.2	10.59
2015-16	24.16	23.19	23.65	19.96	9.04

Rural development has the twin objective of economic betterment of rural people and their social transformation. The quality of life of rural people can be improved through a multi pronged strategy of providing livelihood opportunities, employment, social security, building infrastructure, watershed development programs and land reforms. One of the prerequisites of rural development is financial development which includes financial widening (growth of financial institutions and services) and financial deepening (increase in the per capita amount of financial institutions and services). During 2015-16, among the agricultural households, a majority of 25% loans are reported to have been taken loan to meet capital expenditure required for agricultural purposes, and about 19% loans were taken for meeting running expenses required for agricultural purposes. This is reflective of the fact that a sizeable proportion of loans taken by agricultural households were sought for productive purposes which will help the household achieve better economic returns in future (NAFIS, 2016-17). Financial inclusion has attracted lot of attention of the policy makers recently.

Financial inclusion can be defined as "the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost" (Committee on Financial Inclusion headed by Dr. C Rangarajan, 2008). There are certain characteristics unique to the rural credit markets which makes lending by institutional sources particularly risky and costly.

These are:

1. High cost of administering the loan and auditing cost
2. Lack of collateral and credit worthiness
3. Complicated banking procedures
4. Bank products not suited to the requirements of the poor : loans required for short duration and higher frequency of repayments

The rural people need small amounts of loans due to which lending becomes extremely costly for the bank. Due to adverse selection, the banks are not able to distinguish between low and high risk borrowers and due to moral hazard, it is difficult to supervise the end use of credit leading to lot of default. The lack of collateral makes the lending additional risky (Ghatak & Guinnane, 1999; Ghosh, Mukherjee and Ray,1999; Banerjee & Duflo, 2010; Murdoch, 2000). The rural people also find it difficult to borrow from the commercial bank due to lack of awareness about the banking procedures. As a result, rural poor gets excluded from the formal banking system resort to borrowing from the non-institutional sources. According to NAFIS (2016-17), 40% of the loans of the rural households were taken from friends and relatives, local landlords and moneylenders in the period from July 2015 to June 2016.

The Micro-finance program

Micro finance has become an alternative source of credit for the poor. There are two models of micro finance in India. One is through the micro finance institutions such as NGOs, NBFCs, cooperatives, commercial and regional rural banks etc. which access finance from banks and other mainstream institutions and provide finance and support services to the poor. The other is the provision of finance through the self help groups (SHG). We focus on the latter one which is the dominant model of micro finance in India. NABARD launched the SHG bank linkage model in the year 1992 initially to cover 500 SHGs. The SHG model of micro finance is the largest micro finance program in the world touching nearly 11 crore households through more than 87 lakh SHGs with deposits of over 19,500 crore and annual loan off take of more than 47,000 crore and loan outstanding of over 75,500 crores. The objective of this intervention by NABARD was to promote gender equality and development. The main focus of these intervention is on women as they are particularly vulnerable due to lack of assets, education etc.

According to the Reserve Bank of India, " a self-help group is a registered or unregistered group of micro entrepreneurs having homogenous social and economic background, voluntarily coming together to save small amounts regularly, to mutually agree to a common fund and to meet their emergency needs on mutual help basis". The group members use collective wisdom and peer pressure to ensure proper end use for credit and timely repayment thereof (RBI website). The group consisting of 10-12 women determine their own rules for lending and saving. When these group shows mature banking behaviour, they become eligible for borrowing from the bank. The lending by the bank falls in the priority sector lending of the latter. Studies shows that micro-finance joint liability contract offer dynamic incentives, screens borrowers (assortative matching alleviating the problem of adverse selection), monitors members (if the monitoring cost is low), impose social sanctions (used to punish defaulting member) which solves the problem of moral hazard and lowers expected auditing cost (Karlan and Zinman, 2010; Ghatak and Guinnane, 1999).

3. Research Methodology

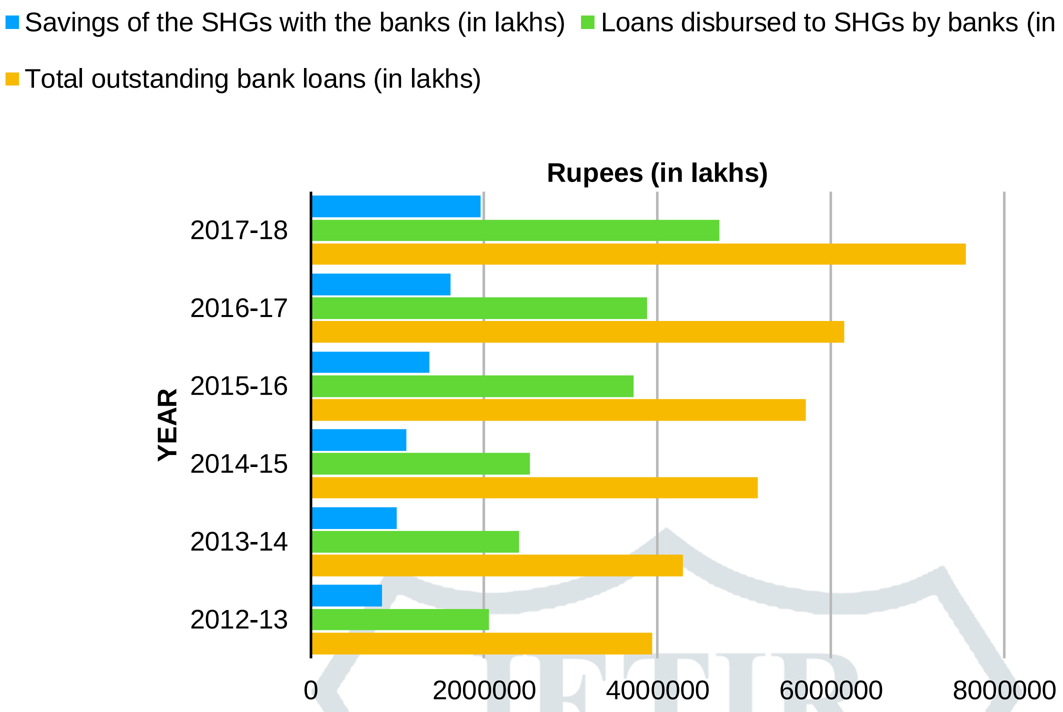
The paper is written using secondary data. The secondary data are collected from various reports such as NABARD' S Status of micro-finance in India report. Various surveys conducted by the government organisations also provide us with statistics which we have analysed such as Agricultural census and NABARD'S All India Rural Financial Survey. Basic tools of economic analysis such as tables, graphs and charts are used to analyse the trends in the micro-finance sector.

4. Role of micro finance in rural development

Micro-finance performs the following role in the Indian economy:

1. Savings : The members of the SHG make a regular and fixed contributions towards the common pool of funds which is used to lend money to the members in need of credit. Under the SHG program, banks were encouraged to open saving accounts in the name of the SHG. The "compulsory savings" in the design of the SHG bank linkage model develops a thrift discipline in the members. The pooled savings of the SHG also helps in developing trust amongst the members of the group. Members feel encouraged to save in other institutions apart from the savings in SHGs and thus reducing their informal multiple borrowings. Graph 1 shows how the savings of the SHGs is growing over the years. 79.8% of the agricultural households reported to have savings in the bank and 30.4% with the SHGs in the period from July 2015 to June 2016 (NAFIS, 2016-17).

GRAPH 1: SAVINGS, LOANS DISBURSED AND LOANS OUTSTANDING (2012-18)



2. Credit : Micro finance provide the rural people with an alternative source of funds, especially to those who are excluded from the formal banking system. From graph 1, one can see that both loans disbursed to SHGs and loan outstanding is increasing over the years. Studies show that access to financial services and the strengthening of the own account agriculture activities of SHG members is associated with less vulnerability in terms of higher savings, less onerous debt and less crises-related borrowing and more investment in productive activities and fewer months of seasonal migration (Kabeer and Noponen, 2005). Despite the progress over the years, 42% of the SHGs ie. 37.24 lakh are still to be credit linked as only 50.20 lakh SHGs had outstanding loans with the banks as on 31st March, 2018.

3. Employment : As per 2001 census, during 1991-2001 , net migration from rural to urban areas was 58 lakhs. Between 2001 and 2011, the share of work related migration decreased from 16% to 13%. Given this, there is a need to generate additional employment in the rural sector itself and micro finance has a lot of potential on that front. Micro finance has seen to positively impact education and entrepreneurship (Kabeer and Noponen, 2005). The labour force participation rate for rural females in 2015-16 was 31% vis a vis 78% for rural males (fifth annual employment-unemployment survey). The SHG model promotes women entrepreneurs by providing training and skill development. Women of the mature SHGs set up and run micro enterprises to earn their livelihood in farm and non-farm sector.

4. Women empowerment: SHG program also empowers women by various means. As mentioned earlier, it promoted employment and entrepreneurship leading to income generation. Studies show that micro -finance has a positive impact on investments in children's education (Khandkar, 1998; Viswanath, 2018). Few studies shows participation in these programs positively impact political participation of women at the grassroots level by promoting collective action (Mani and Iyer, 2018; GOI,2008). Women also attach more self worth and self confidence and could move more freely after joining SHG (Kabeer, 2001; Kabeer and Noponen, 2005; Mani and Iyer, 2018).

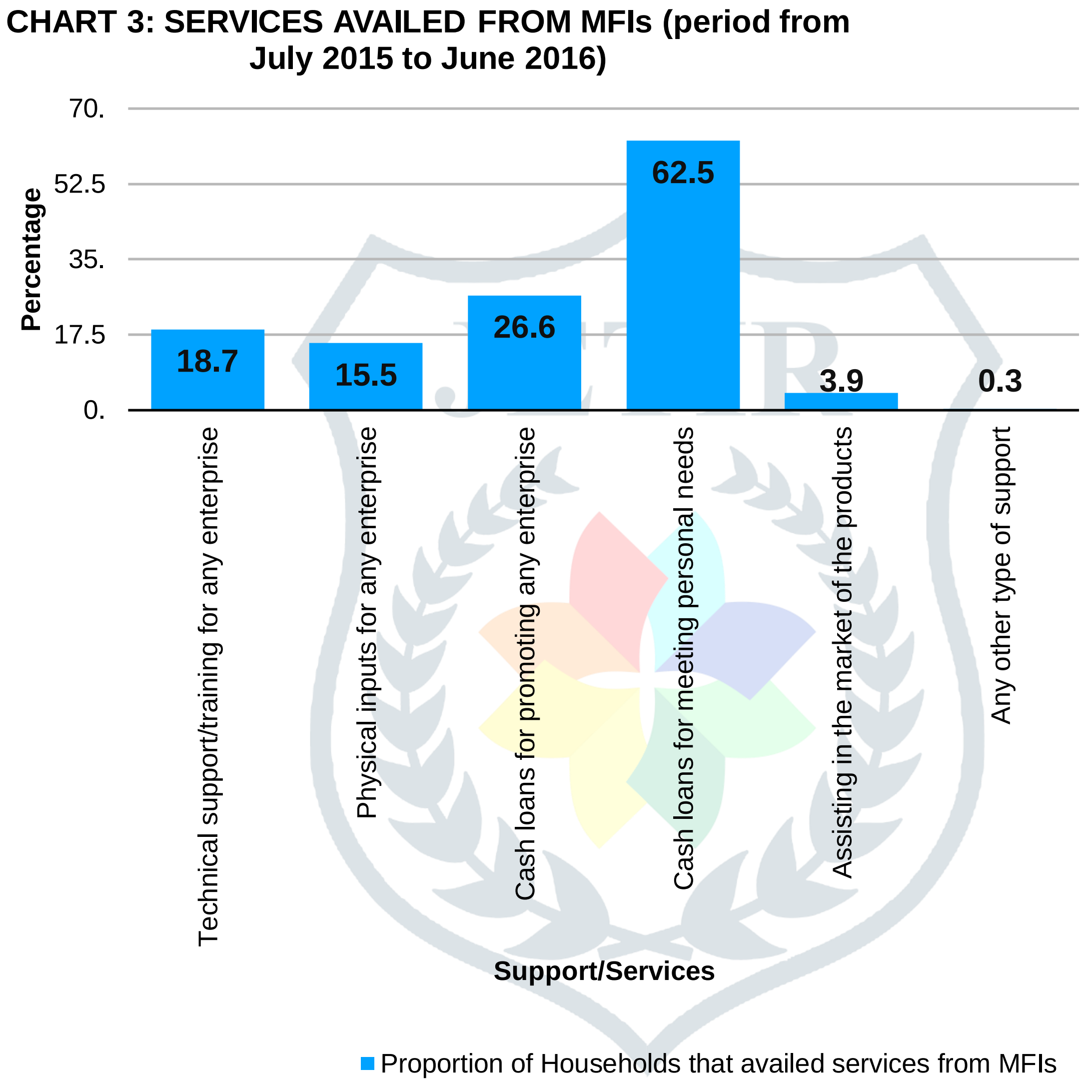
5. Poverty alleviation : SHG Bank linkage program is seen as an anti-poverty tool. By providing finance to the unbanked rural poor, it enables them to get involved in productive enterprises to earn a livelihood and hence contributes to increasing incomes. Studies show that members report that the SHG program has a significant and positive impact in improving their livelihood, living and consumption standards (Kabeer and Noponen, 2005). Moreover, it provides protection from the moneylenders as well as health shocks which are other reasons for pushing them into further poverty.

6. Entrepreneurial development : NABARD runs micro enterprise development program to nurture the enterprises set up by the SHG members. In the year 2014, around 80,660 establishment were established by taking a loan from SHG. "Those members who were not economically active previously were able to start up new activities. Others were able to put pre-existing enterprises on a more secure basis and others move into home based enterprises rather than working for others which they found demeaning" (Kabeer, 2001).

7. Financial inclusion: The very objective of this program was financial inclusion because despite nationalisation of banks, majority of the population remained outside the formal banking sector. Data from the 2011 census indicates that 58.7% of households in India avail the financial services of which 54.5% is in rural areas and 67.7% is in urban areas. Mor committee (2013) estimated that under certain assumptions, overall number of financial inclusion is 36% with 32% of rural population having bank accounts. As a financial inclusion mechanism, the programme is a complete package, beginning with imparting basics of financial literacy, savings and credit management within group and later graduating to availing of credit from the banks (NABARD ,2017-18).

Source: NABARD All India Rural Financial Inclusion Survey 2016-17

NAFIS, 2016-17 reports that 22% of agricultural households report to have at least one member associated with the SHGs. The graph shows the kind of services and support agricultural households received from micro finance institutions in the period from July 2015 to June 2016. Cash loans for meeting personal needs was most common service reported by 62.5% of the agricultural households. Another prominent service was cash loans for promoting enterprise reported by 26.6% of the agricultural households.



5. Challenges faced by micro finance agencies

1. Universal coverage of the poor through SHG mode has not been achieved. Northern,Central,North-eastern and eastern region has been largely underserved. Data shows that a lesser degree of repeat financing is happening in these states. Much of the micro-finance movement has been successful in the southern states. The lack of a dedicated NGO moment in the other parts of the country is responsible for this. There is a need for good self help promoting institutions to prevent disintegration of SHGs as well as promote the formation of SHGs in the underserved regions.

2. There is a problem of non-performing assets (NPAs) in the micro finance sector. Graph 2 shows the NPAs of the SHGs with the banking sector as a proportion of loans outstanding. As the graph 2 shows NPAs were 7.4% in the year ending 2015 fell by about 100 basis points to 6.4% in the year ending 2016. NPAs were around 6% in the year ending 2018. Though it has declined but still is high. The lack of credit rating of the SHGs is responsible for this. There is need to properly identify eligible SHGs, estimate their credit requirements and help them to take up productive viable projects. Hopefully, with the digitisation drive E- Shakti, the proportion of NPAs may also come down.

3. Banks are unable to properly appraise and monitor SHGs which is leading to the problem of wrong identification of SHGs, disintegration of SHGs and rising level of NPAs. Also the bookkeeping practices of the SHGs are not to the satisfaction of the banks. Lack of transparency of the groups and a credit history of the self help groups makes it all the more difficult for the banks. There is a need for proper appraisal of SHGs eligible for loans and a regular monitoring and support is required so that SHG operations are sustainable. A step forward to solve this problem was taken by NABARD with the launch of the e-Shakti in March 2015. The attempt is to provide reliable and up to date financial and non financial data of SHGs and their members to bankers and other stakeholders with a view to helping them in taking appropriate credit and policy related decisions quickly (NABARD, 2017-18). E-shakti shall enable bankers ease of doing business with SHGs and their credit ratings. Most of the rural poor are financially illiterate, therefore implementation of the e-Shakti program is a challenge. According to the 2016 report (finTech Trends Report, India 2017, PwC), India belongs to the high finTech need and less supportive finTech infrastructure and ecosystem zone. Many areas which are served by the micro-finance institutions do not have infrastructure to support the technology such as electricity, transportation, communication devices, internet etc. which is a big hurdle in the adoption and implementation of technology. According to a report published jointly by the Internet and Mobile Association of India (IAMAI) and KANTAR-IMRB, mobile internet penetration in rural India remains as low as 20%. The share of wireless rural subscribers was only 45% as on 31st December, 2018.

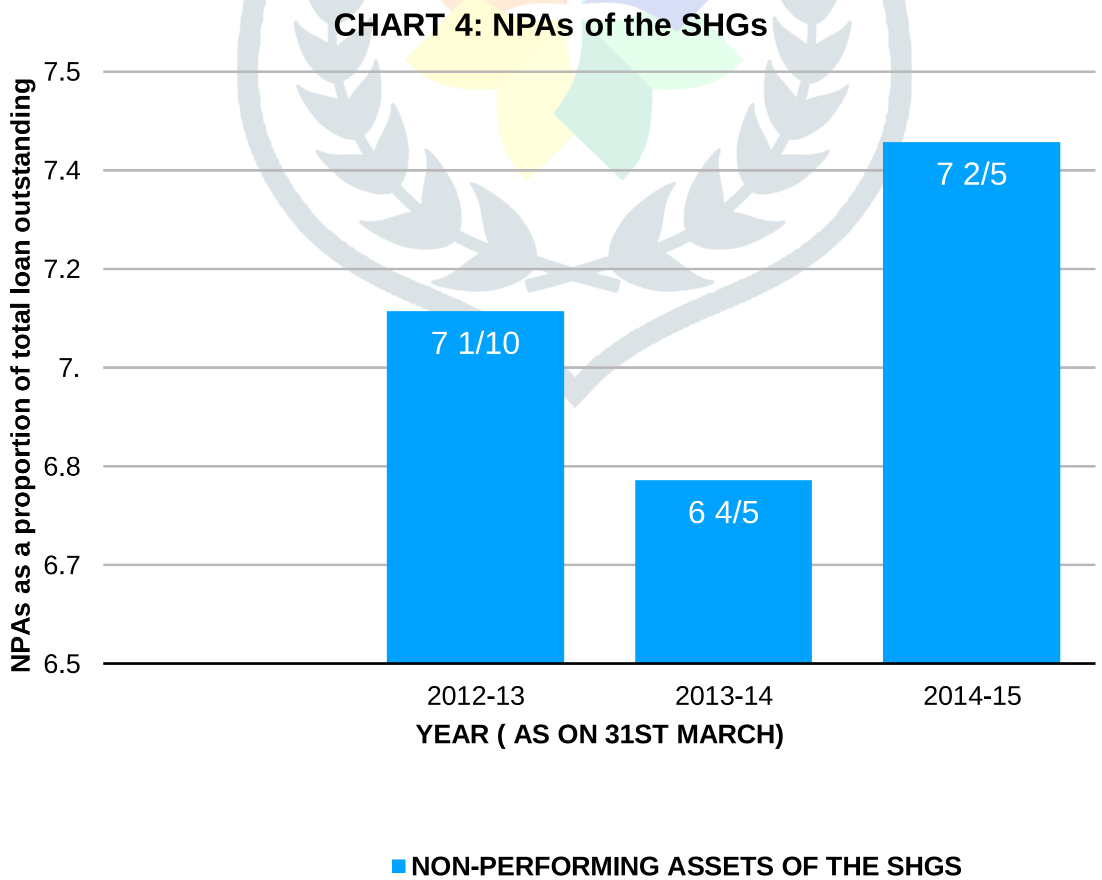
4. To serve the objective of gender mainstreaming, majority of the SHGs are made to comprise only of women members. For example, out of total 87.44 lakhs SHGs saving linked with the banks, 73.9 lakh were exclusive women SHGs, as on 31st March, 2018. Also out of total 50.2 lakh SHGs having loan outstanding, 45.49 lakh were exclusive women SHGs. However, for the program to serve the purpose of financial inclusion and poverty eradication, men should also be encourage to form these groups and become entrepreneurs.

5. There is a huge demand and supply gap in the credit requirement of the poor in the rural sector, therefore depending on micro-finance model for it solely is not the right thing to do.

6. Policy suggestions

1. Wage employment : In the SHG bank linkage model, the groups are encouraged to get self employed to earn a livelihood. For this NABARD provide training for skill development to the SHG members. However, it has been seen that in the absence of markets and other reasons, members are not able to open their enterprises or operate them on a sustainable basis. Therefore we suggest that members of the SHG should be encouraged and imparted training for wage employment. This will increase repayment and hence reduce the disintegration of groups.

2. Creation of markets and or integrating the rural markets with other markets: Many SHG which engage in production of goods like handicrafts, textiles, etc. are not able to generate sufficient income because of lack of markets. Hence the entire purpose of enabling SHG to be self sufficient gets defeated. Therefore, it is required that the access to markets should be improved. The village markets being integrated with the nearby town markets could be a possible solution to this problem.



3. The need of the time is good self help promoting institutions with a trained and experienced staff. Self help promoting institutions (SHPIs) are required at every stage in the entire process such as identification and formation of eligible SHGs,

providing support to the members for taking up productive employment, marketing support etc. If these SHPIs play a responsible role then disintegration of the SHGs can be contained.

4. Digitisation : There is a need to expand the e-Shakti project in all districts of the country. Presently the project is operative in 100 districts across the country. The project entails making available all the financial and non-financial information in a digitised form to all the stakeholders. This shall increase the transparency of the SHG operations and may prove to be particularly helpful for the banks to monitor the SHGs. The challenges in the expansion of this project are enabling infrastructure and constraints with regards adaption of technology by the local rural poor.

7. Conclusions

Failure of both institutional and non-institutional sources of finance warranted an alternative finance mechanism. Micro-finance creates self employment opportunities which attacks the problem of poverty and unemployment. It also provide protection against health shocks to the rural poor as they can access funds from the group corpus in times of emergency. This paper talks about the contribution of micro-finance to rural development, recent challenges faced by the micro-finance institutions as well as suggest policy measures to create enabling environment for success of the program. We suggest that the SHGs shows be given handholding support by NGOs so that they can use the credit more effectively. The digitisation of financial and non-financial information of the SHGs should be done throughout all the districts of the country to further the objective of credit deepening. Also, since the success of digitisation shall depend upon the supporting finch infrastructure, necessary steps should be taken to develop that. One of the reasons for the disintegration of SHGs is that enterprises are not able to find a market for its produce making them unsustainable. Thus, we suggest that the rural markets should be integrated with the nearby markets and training imparted to the members of the SHGs could be directed towards exploiting wage employment opportunities. We need “political will” which aims at not just increasing the number of SHGs on paper but also makes them sustainable and effective.

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