



ROLE OF MICROFINANCE INSTITUTIONS IN RURAL DEVELOPMENT – OVERVIEW OF RELATIONSHIP, AVENUES AND CHALLENGES

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Abstract :

Microfinance is a concept which tries to improve the living condition of poor and unemployed in long term. Microfinance provides financial services to people with no access to capital and commercial banking services. Since 1990s, poverty reduction has taken priority at both national and international development levels. Considering this scenario this paper emphasizes on study of relationship between rural areas of India and microfinance. Recently, Microfinance Institutions have developed much new mechanism to cater to the needs of rural people but still they are partially inefficient on the aspect of their development. MFIs can play a vital role in bridging the gap between demand and supply of financial services which will indirectly help in uplifting the standard of living of rural people only if some of the critical challenges confronting them are addressed. Thus, this paper describes the relationship between the MFI's and rural development, the loopholes in operational efficiency and study of multiple challenges affecting proper implementation of microfinance in rural areas. This paper is conceptual in nature and based on secondary data entirely.

Keywords— Microfinance, Rural Development, unemployment, Poverty eradication.

Introduction:

People from the rural areas used to manage their financial resources by mobilizing it to either establish or develop the business, to finance their agricultural activities, their dwelling with the passage of time.

The main objective of rural development is to improve their quality of life. It has given a chief importance in the development of overall economy

of India. A typical or traditional financial institution has a very scarce provision towards the needs of low income families or families headed by women.

Latest data of census 2011 shows that large number of population still lives in rural areas. According to census report 2011, 68.84% of the total population of India is living in 6, 40,867 villages and only 68.9% rural population is literate out of it. This shows that we need to focus on almost 32.1% of the rural population.

The Government of India has been introducing the diversified policies for the rural areas to tackle the issues particularly unemployment, poverty. But the outcomes resulting out of it are very dissatisfactory. In case of agriculture credit supply, the overall accessible credit supply to the rural areas as a percentage of total disbursement of credit is going down day by day. Though the share of formal credit as a part of agriculture GDP is growing, but on the other hand, rural individual is not capable of establishing effective relationship with supply of credit and productivity.

The income of population of rural households is not substantial even though their size of business is large or small. But nowadays financial institutions also seek to deal with immense amount of loan but a small number of borrowers so that their administration cost can be reduced. These factors are creating a gap in the development of rural areas.

Objectives

1. To show relationship between microfinance and rural areas.
2. To study operational inefficiency affecting microfinance development in rural areas.
3. To know the distinct avenues of Microfinance for rural development in India.
4. To study challenges faced by microfinance institutes in rural areas.

Microfinance in India

Banks has many limitations while providing loan to poor people like lack of security and high operating cost and so Microfinance was developed as an alternative to provide loans to poor people with the goal of creating financial inclusion and equality.

Concept of microfinance was firstly introduced in Bangladesh in the form of "Grameen Bank". NABARD has drawn this idea and started Microfinance in India.

Microfinance has following features:

1. MFI gives loan to those who are Below Poverty Line(BPL)
2. Maximum amount of Rs.25000/-loan can be given.
3. Loans are given without any security.
4. Terms and conditions given to poor are decided by NGOs
5. India has some 223 MFIs, including societies and NGO-run entities, and 168 of them are registered with Sa-Dhan, the association of community development finance institutions. There are 47 non-bank finance company-micro finance Institutions (NBFS-MFIs) registered with microfinance Institutions Network (MFIN).
6. Although there is demand for credit by poor and women at market interest rates, the volume of financial transaction of microfinance institution must reach a certain level before their financial operation becomes self sustaining. In other words, although microfinance offers a promising institutional structure to provide access to credit to the poor, the scale problem needs to be resolved so that it can reach the vast majority of potential customers who demand access to credit at market rates.

Products of Microfinance Institutions

Microfinance Institutions deliver several products according to the need of target groups to be catered by them, credit is only one of the product. The product range of MFIs typically includes:

1. Purely individual loans.
2. Individual loans with group guarantee and group loan.
3. Saving.
4. Micro insurance.
5. Money transfer

Relationship between Microfinance and Rural Development

Rural development is also considered as an important segment of economic development. It is not only about to change economic proposition of the rural areas, but also change in social, psychological and cultural dimensions for poverty alleviation, employment generation, infrastructural development, social security and sustainable development in the rural areas. For, rural development, alleviating rural poverty and providing an improved quality of life for the rural population especially those living below the poverty line is highly required. Hence, it is a process, which aims at improving the well being and self realization of people living in the rural areas through collective process.

The government of India has also been proposing various programmes to capture the trouble like unemployment and poverty, particularly in rural areas, but, the fallouts are below the satisfactory level. The involvement of NGOs and private players in the name of rendering small financial services to the rural poor for rural transformation has also been very prominent in developing countries including India since late 80s.

Microfinance is a form of financial services for entrepreneurs and small businesses lacking access to banking and related services. Microfinance is an evolution having inspiration towards the world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial 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. For others, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

Operational Inability

It is accepted that commercial lending institutions expects at least the stable income source out of which they can pay their principle and interest amount back according to agreed terms.

Both the medium of operations adopted by financial institutions and economic characteristics or financing needs of low income households are creating discrepancies in the form of low access to credit facilities.

[I] Cash Transactions

With most of the customers being from the lower strata of society, the transaction undertaken by MFIs are majorly cash driven. MFIs incur significant a cash-carrying cost as they forgo the interest for assets held in currency along with an insurance premium to safeguard the cash in transit. Frauds or thefts by third parties on cash held by borrowers also have an impact on the customer's ability to pay.

[II] Technology

Use of technology can reduce the operational costs for MFIs Substantially; however, these organisations, particularly small and medium-sized MFIs, do not have the required capital to investing technology. The lack of capital translates into use of low-cost and locally developed solutions which do not have the industry best practices embedded. This further increases the operational challenges, impacts adoption, and leads to an increase in manual intervention in processes, thus impacting both efficiency and cost. Use of local and low-cost technology solutions also has an impact on the credit ratings by ratings agencies, impacting the MFI's ability to raise funds at a lower cost. Further, for MFIs concentrated in rural and semirural areas, technology adoption remains a challenge due to infrastructural issues like lack of electricity and broadband connectivity.

[III] Fraud

Lack of an effective risk management framework and controls is a major challenge faced by MFIs. Greater manual intervention in processes due to use of local and low-cost technology reduces the number of systematic controls and automated data collection, increasing the probability of internal fraudulent activities by employees. In addition, MFIs have observed instances of certain borrowers taking advantage of the large loan size and becoming moneylenders, thereby defeating the very objective of curbing illegal money lending.

[IV] Human resources

Smuggling of resources from mid- and small sized MFIs by the larger MFIs is one of the biggest challenges faced by the industry. Due to the access to low-cost capital and funds, coupled with balance sheet size, the larger MFIs can offer to reinforce the compensation to employees from mid-and small sized MFIs, indirectly increasing attrition at these institutions. A loaf of costs incurred in recruitment, MFIs also provoke substantial training costs due to the lack of sector-specific training courses in Indian educational institutions.

In addition, diagnosing personnel with specialised and admissible set of skills for different operations within the organisation is a challenge faced by industry players as the sector has been scaling up only recently. While the core values, vision, mission and code of conduct forms the basis of organisational culture in MFIs, they are densely inveigled by the top management of the firm. Regulating this culture through professional HR and operational practices remains unaddressed.

Microfinance Delivery Models in India

The non-availability of credit and banking facilities to the poor and underprivileged segments of the society has always been a major concern in India. The Government and the Reserve Bank have taken several initiatives, from time to time, such as nationalisation of banks, prescription of priority sector lending norms and concessional interest rate for the weaker section of society. It was, however, realised that further direct efforts were required to address the credit needs of poor people. In response

to this requirement, the Micro finance movement started in India with the introduction of SHG bank linkage programme (SBLP) in the early 1990s. At present, there are mainly two models for delivery of Microfinance in India:

1. SHG – Bank Linkage Programme (SBLP)

A SHG is a small group of about 10-20 persons from a homogeneous class of rural and urban poor which promoted savings among members and used these resources for meeting their credit needs. The group is democratically formed and elects its own leaders. The vital features of SHGs are it consists of members belonging to the same community or society and having common economic goal. In this model, the informal SHGs are credit linked with the formal financial institutions.

The SHG-Bank Linkage Model has emerged as a dominant model in terms of number of borrowers and loans outstanding. This model is flexible, independence creating, and imparts freedom of saving and borrowing according to the requirements of group members. Due to widespread rural bank branch network, the SHG-BLM is very suitable to the Indian context. Microfinance movement started in India with the introduction of SHG Bank Linkage Programme (SHG BLP). The programme uses SHGs as an intermediation between the banks and the rural poor to help in reducing transaction costs for both the banks and the rural clients.

- i. **Model I:** SHGs Formed and Financed by Banks: In this model, banks themselves take up the work of forming and nurturing the groups, opening their savings accounts and providing them bank loans.
- ii. **Model II:** SHGs Formed by Agencies Other than Banks, but Directly Financed by Banks: In this model, NGOs and other formal agencies in the field of microfinance facilitate organising, forming and nurturing of SHGs and train them in thrift and credit management. The banks directly give loans to these SHGs.
- iii. **Model III:** SHGs Financed by Banks Using Other Agencies as Financial Intermediaries: This is the model where the NGOs take on the additional role of financial intermediation along with the formation of group. In areas where the formal banking system faces constraints, the NGOs are encouraged to form

groups and to approach a suitable bank for bulk loan assistance. This method is generally used by most of the NGOs having small financial base.

2. Micro Finance Institutions (MFIs)

The MFI model has also gained momentum in India in the recent past. MFI model is found worldwide whereas the SHG-BLM model is an Indian model. In MFI model MFIs borrow large amount of funds from the apex financial institutions, donors and banks for on-lending to the individuals or groups. These MFIs provide financial services to the individuals or to the groups like SHGs. 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. MFIs in India exist in a variety of forms like trusts registered under the Indian Trust Act, 1882/Public Trust Act, 1920; societies registered under the

Societies Registration Act, 1860; Cooperatives registered under the Mutually Aided Cooperative Societies Acts of the States; and nonbanking financial companies (NBFC)-MFIs, which are registered under Section 25 of the Companies Act, 1956 or NBFCs registered with the Reserve Bank. These MFIs are scattered across the country and due to the multiplicity of registering authorities.

Role and Importance of Microfinance in India

According to the research done by the World Bank, 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. Thus Microfinance plays a major role in upliftment of Indian economy in following ways:-

- i. **Credit to Rural Poor:-** Usually rural sector depends on non-institutional agencies

for their financial requirements. Micro financing has been successful in taking institutionalized credit to the doorstep of poor and have made them economically and socially sound.

- ii. **Poverty Alleviation:**-Due to micro finance poor people get employment. It also helps them to improve their entrepreneurial skills and encourage them to exploit business opportunities. Employment increases income level which in turn reduces poverty.
- iii. **Women Empowerment:** - Normally more than 50% of SHGs are formed by women. Now they have greater access to financial and economical resources. It is a step towards greater security for women. Thus microfinance empowers poor women economically and socially.
- iv. **Economic Growth:**-Finance plays a key role in stimulating sustainable economic growth. Due to microfinance, production of goods and services increases which increases GDP and contributes to economic growth of the country.
- v. **Mobilisation of Savings:**-Microfinance develops saving habits among people. Now poor people with income can also save and are bankable. The financial resources generated through savings and micro credit obtained from banks are utilised to provide loans and advances to its members. Thus microfinance helps in mobilisation of savings.
- vi. **Development of Skills:**-Micro financing has been a boon to potential rural entrepreneurs. SHGs encourage its members to set up business units jointly or individually. They receive training from supporting institutions and learn leadership qualities. Thus micro finance is indirectly responsible for development of skills.
- vii. **Mutual Help and Co-operation:**-Microfinance promotes mutual help and co-operations among members. The collective effort of group promotes economic interest and helps in achieving socioeconomic transition.
- viii. **Social Welfare:** - With employment generation the level of income of people increases. They may go for better education, health, family welfare etc. Thus micro finance leads to social welfare or betterment of society.

Challenges In Front Of Microfinance in Rural Areas

The major challenges to delivery as well as conduct of micro-finance are:

As this sector mainly deals with the poorer section of the country, over-indebtedness is a common and serious challenge faced by the MFIs in India. Some of the other challenges are:

1. High Rate of Interest

MFIs' when compared to commercial banks do not enjoy the same rate of financial success. One of the reasons is that while banking system is centuries old, micro finance is only a few decades old in India. MFIs' charges a very high rate of interest (12-30%) as compared to commercial banks (8-12%).

2. Over Dependence on the Banking System

Many of the MFIs' in India are registered under a Non Governmental Organizations (NGOs). They are dependent on financial institutions such as commercial banks for stabilized funding for their own lending activities. Around 80% of their funds come from banks. Most of these are private banks which charge a high rate of interest and also the term of loans is of shorter period. Commercial Or private sector banks lend to micro-fin firms in order to meet their priority sector loan targets. Thus, the over dependence of Indian microfinance industry on banks make them incompetent and less reactive towards dealing with default and delinquencies.

3. Illiteracy and lack of awareness about the products.

As we know that the literacy rate in India is very low and this literacy rate is much lower in rural area. Many of the rural population are not in status to understand the information, or benefits of the products of MFIs. This becomes the challenge for both MFIs and customers. This awareness issue is creating barrier to rural people to get connected with the MFIs to meet their financial needs. Thus, MFIs are facing the task educating the people about their products and building trust with them.

4. Proper Financing Structure:

Microfinance Institutions are created by NGOs. Moreover, NGOs are not allowed to lend finance support to any as they could violate the section 11(4) of the Income Tax ACT. This could make them lose their "charitable status" under Section 12 of the Act. As such micro financing, to whomsoever it may concern, cannot be an activity of charity according to Section 2(15) of the Income Tax rules. The other thing is that NGOs as such do not have

the appropriate financial structure to undertake microfinance activities.

5. Demand and Supply Gap

Numerous initiatives taken by government and financial institutions have not aided the rural poor in improving their standard of living. Analyzing the patterns of providing credit to the rural sectors, there seems to be a large gap between the needs of rural households related to savings and credit options, and the receiving of the same from a range of financing institutions.

6. Repayment Issues

As such micro-credit is not based on documentary evidence, so repayment tracking becomes a huge operational task. Further, in times of emergencies like natural disasters where the entire rural economy is affected, the FIs are faced with a situation of write-off of the entire portfolio as there is no other alternative for risk mitigation.

Conclusion:

The importance of microfinance in the developing countries cannot be undermined as it plays a vital role for socio-economic upliftment of poor and low income peoples. The functioning of Microfinance institutions in India is playing an important role in rural areas since last three decades. Since 1990s, poverty reduction has taken priority at both national and international development levels. Within this framework, various initiatives have been taken by government. Even after the microfinance promises upliftment of poor, there are very few cases which have made small business owners rich. As loan origination is just the small fraction of the story but building even a small successful business in today's environment requires skills, education and management which are lacked in the models of microfinance. But the benefits obtained even from the current microfinance business models are large as in the regions of country where microfinance activities are in nascent stages. Hence Microfinance contributes significantly towards improving the standard of living of poor. The economic development of any country is severely influenced by the availability of financial services. The growing sector of microfinance is in booming phase even after surviving crisis in Andhra Pradesh and it needs a proper attention at regulatory level.

Therefore the basic conclusion of this study is that it is necessary that govt. of India have to focus on

extending financial services to both rural and urban to ensure sustainable and inclusive growth by using innovative techniques like securitization by transferring risk and businesses can leverage new business models to provide opportunities to poor which they could not enjoy earlier. MFIs and SHG programs must be strongly implemented with focusing towards low administration cost by using appropriate governance. The central government and RBI should take necessary measurements to sustain the growth of the microfinance sector in India. The concern state governments also take necessary measurements to create awareness among people to use the services of Microfinance institutions to strengthen their Economic status and improve their livelihood.

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