



## **Developing rural poor through micro finance: Problems and prospects**

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### **Abstract**

The present paper has been devoted to discuss the problems and prospects of developing the rural poor through Micro Finance. Micro Finance has come to include a broad range of service-credit, saving and insurance. Thus, the typical micro finance clients are low income persons who do not have access to formal financial institutions. Micro Finance is provided by NGOs, credit unions, co-operatives, private commercial banks and non-bank financial institutions. NABARD continued to provide 100% refinance to banks at an interest rate of 6.5% per annum for financing SHGs. It has been aptly observed that political interference and bureaucratic procedure are key problems in the working of MFIs. Lack of democratic functioning, delays in operational aspects, lack of appropriate legislation to regulate the credit flow to the poor, social exploitations by the private money lenders charging high rate of interest and by-passing the needy persons, weak banking system unable to access the poor, officials indulging in corrupt practices are the main problems faced by the beneficiaries. For improving the Micro Finance the suggestions include generation of awareness, encouraging FIs, expediting services, making policy changes and modification in NABARD Act, removing monopoly of government and making provision of social audit.

**Keywords:** developing rural, rural poor through micro finance

### **Introduction**

The need for Micro-Finance (MF) is inevitable because of the fact that even after fifty years of independence our achievements in the development sector have remained below expectations. The twin problems i.e. unemployment and poverty have posed major challenges for us in the development of rural areas. This state of affairs is because the demand for credit to start any micro-enterprise by the rural poor could not be met by the institutional initiatives taken for providing rural finance. It has been found that due to the failure of percolation theory of social development, poor people are highly dependent on non-institutional sources of credit. This situation has arisen despite the high opportunities of employment generation that lie in Agro Sector and Rural Non-Farm Sector. Growth of Micro Finance in India is not ad-hoc in nature. It is in response to the failure of institutional initiatives and exploitation attached with informal system of credit. By getting a tip from the Grameen Bank of Bangladesh, NGOs in India acted very quickly to promote the growth of Micro Finance in our country. It has been aptly observed that growth and emergence of Micro Finance sector has proved very useful for the women who come forward to mobilize their own savings, ultimately leading to equality and equity with their men folks. According to a rough estimate, in 2004, there were about 800 Micro Financial Institutions (MFIs) in India which were actually undertaking lending activity.

### **Concept of micro finance**

Both the terms i.e. Micro-Credit and Micro Finance are closely related to each other. Poor people need Micro Finance and Micro Credit for purposes like household expenses,

emergency needs or even basic livelihood support. There are two main systems of micro credit. One is formal financial institutions, banks and co-operatives, which provide micro credit to the poorer under different schemes for livelihood support or helping them to start micro enterprises.

The other is informal system comprising traditional money lenders, prawnbrokers and trade specific lenders. Micro Finance came to prominence in the 1980s, although early experiments date back 30 years in Bangladesh, Brazil and few other countries. It has been realized that it is one of the sustainable tools to address poverty. The important difference of micro finance and micro credit that it avoided the pitfalls of an earlier generation of targeted development lending, by insisting on repayment, by charging interest rates that could cover the costs of credit delivery and by focusing on client group whose alternative source of credit was the informal sector.

Micro Finance came experiments date back 30 years in Bangladesh, realised that it is one of the sustainable tools to Micro Finance and Micro Credit that it avoided development lending, by insisting on repayment, the costs of credit delivery and by focusing on was the informal sector. Emphasis shifted from prop up targeted sectors towards the building up poor. Micro Finance has largely been a private (non overtly political, and as a consequence, has outperformed lending. Micro Finance increasingly refers to a host of financial services-savings, loans, insurance, remittances from abroad and other products. It is hard to imagine that there would be any family in the world today, for which some type of financial service could not be designed and made useful. But the fact of the matter is that in most people's mind "Micro Finance" still refers to micro credit. Micro Credit is provided

to extremely poor people who do not have any stable income such as the very destitute and the homeless. They are not the clients of micro finance and cannot repay the loan. So we can say that micro credit is the part of micro finance.

### **Micro finance defined**

Traditionally, Micro Finance focused on providing a very standardised credit product. The poor just like anyone else, need a diverse range of financial instruments to be able and to build assets, stabilise consumption and protect themselves against risks. Thus, we see that the concept of Micro Finance has broadened. In other words, we may say that Micro Finance means providing very poor families with very small loans (MC) to help them engage in productive activities or grow their tiny businesses. But over the time, Micro Finance has come to include a broaden range of service-credit, saving and insurance. Through experiences we have realised that the poor and the very poor who lack access to traditional formal financial institutions, require a variety of financial products. The 'Task Force on Supportive Policy and Regulatory Framework for Micro Finance' constituted by NABARD defines, Micro Finance, "as the provision of thrift, saving, credit and financial services and products of very small amounts to the poor in rural, semi-urban and urban area for enabling them to raise their income levels and improve their standard of living".

### **Features**

Some of the important features of Micro Finance are as given below:-

- The target of Micro Finance is rural and urban households,
- Credit under Micro Finance follows thrift i.e., mobilize savings
- Transaction cost is low. Operation is transparent. Period of repayment is short.
- The process of Micro Finance is liberal for processing and delivery of credit.
- No collateral security is required for loans.
- Loan disbursements are made on the basis of requirement.
- Prompt repayment are made and there is no ceiling from RBI in respect of minimum and maximum amounts.

### **Clients**

The typical Micro Finance clients are low income persons who do not have access to formal financial institutions. Micro Finance clients are typically self-employed often house- hold-based entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income generating activities such as food processing and petty trade. urban areas, Micro Finance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc. Thus, Micro Finance clients are poor and vulnerable non-

poor who have a relatively stable source of income.

### **Service Providers**

Services of Micro Finance are being provided by various MFIs. There are three following types of MFIs:

1. Non-Profit MFIs: These include societies registered under Societies Registration Act- 1 860 or similar State Acts, Public Trusts registered under the Indian Trust Act-1 882 and Non- Profit companies registered under Section-25 of the Company Act-1 956 and Self Help Groups/ Federations.
2. Mutual Benefit MFIs: Such as State Credit Co-operatives, National Credit Co-operatives, Mutually Aided Co-operative Societies (MACS) and SHGs.
3. Profit Making MFIs: Bodies like Non-Banking Financial Companies (NBFCs) registered under the Company Act-1 956 and Banks which provide Micro Finance alongwith their other usual banking service could be termed as Micro Finance service providers of this type.

In simple words, a MFI is an organisation which offers financial services to the very poor. Most of MFIs are non-governmental organisations committed to assisting some sectors of the low-income population. The term MFI has decided to providing these services - NGOs, Credit banks and non-bank financial institutions (some regulated institutions and parts of state owned NGOs are not allowed to capture savings, deposits are fully and virtually dedicated to offer financial led the development of Micro finance, the world over.

### **Nabard and Micro Finance**

Since the emergence of micro finance sector in India, the role of financial institutions has become significant. NABARD has initiated the process of MF in India through linkage programme of SHGs under automatic refinance scheme. Besides, NABARD in consultation with banks and NGOs issued guidelines on Feb 26, 1992 to enable bankers participate in this alternative credit delivery system. Thus, many NGOs are also actively involved in promoting SHGs. Under the NABARD approach of SHGs linkage, banks extend loans to SHGs either directly or through NGOs. NABARD extends 100% Automatic Refinance Facility at 6.5% per annum to all banks against their lending to SHGs (direct) or through NGOs. Earlier, banks were charging 12% rate of interest if they directly lend to SHGs and 10.5% if they lend to NGOs for on lending, whereas NGOs can charge 12% rate of interest if they lend to NGOs for on lending, whereas NGOs can charge 12% from SHGs. To quote from the brochure of NABARD: "with just 225 SHGs credit linked with banks in 1992-93, this number has grown to over 33,000 SHGs covering almost 5,00,000 rural poor households. NABARD plans to ensure credit linkages of at least one million groups covering almost one third of the country's poor population by the year 2008".

**Table 1: SHG - Bank Linkage Programme - Cumulative Progress**

Years	No. of SHGs linked	Bank Loan	Refinance
1992-93	255	0.29	0.27
1993-94	620	0.65	0.46
1994-95	2122	2.44	2.13
1995-96	4757	6.06	5.66
1996-97	8598	11.84	10.65
1997-98	14317	23.76	21.39
1998-99	32995	57.07	52.06
1999-2000	94645	192.98	150.13
2000-01	263825	480.88	401.00
2001-02	461478	1026.34	796.00
2002-03	717360	2048.67	1412.71
2003-04	1079091	3904.20	2118.15
2004-05	1618476	6898.46	3085.91

*Source:* annual reports of nabard 2000-01 and 2004-05.

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Above table showing cumulative progress under SHG credit linkage indicates that in the year of 1992-93, the number of SHGs linked was of Rs.0.29 crore and refinance was of Rs.0.27 crore. In the year 1993-SHG's and the bank loan and refinance were the order of Rs.0.65 crore and Rs.0.46 crore respectively. The total number of SHGs in 1994-95 linked rose to 2,122 with bank loan of Rs.2.44 crore and refinance Rs.2.13 crore. In the following year 1995-96, the number touched the figure of 4,757 SHGs and the bank loan increased to Rs.6.06 crore and refinance was Rs.5.66 crore. In 1996-97, 8598 SHGs were reported and the bank loan increased to Rs.11.84 crore and the refinance was Rs. 10.65 crore. In 1997-98 the total of SHGs was 14,317, bank loan and refinance were Rs.23.76 crore and Rs.21.39 crore. In the next two years i.e. 1998-99 to 1999-2000, the number of SHGs increased upto 94,645, bank loan rose to Rs. 192.98 crore and refinance was Rs.150.13 crore. Furthermore, in the year of 2000-01, number of SHGs financed by banks was 2,63,825 and the bank provided loans amounting to Rs.480.87 crore and refinanced Rs.401 crore. There has been tremendous increase during the year of 2001 -02 as the number of SHGs increased 4,61,478. Whereas, the bank loans was Rs.1,026.34 crore and refinance was of Rs.796 crore. During the year 2002-03, Rs.2048.67 crore bank loan was disbursed to frame 717360 SHGs and refinance was of Rs.1412.71 crore. The above table clearly shows that in the year of 2003-04, the number of SHGs linked was 1079091 and bank loan was of Rs.3904.20 crore and refinance was of Rs.2118.15 crore. During the year of 2004- 05, NABARD provided refinance of Rs.3085.91 crore for supporting 1618476 SHGs with Rs.6898.46 crore as bank loan.

### Problems

There is no denying the fact that Micro Finance scheme has gained ground yet there are certain problems which need immediate solutions. Some of them are as follows :

- Political interference and bureaucratic procedure are the key problems in the smooth working of MFIs. Threat of supervision of co-operatives through the appointed special officer, lack of democratic working, delays in

operational aspects such as auditing the presence of cumbersome procedure are the aspects attracting special attention the policy-makers, planners and administrators.

- Loan raising has become difficult because all members of the trust are required to an agreement. According to a recent judgement, loans to trusts can't be handled in the same way as loan to other entities. In case one member of trust has not signed, there is ample scope for the trust to get away with not repaying the loan.
- There is a lack of appropriate legislation to regulate the credit flow to the poor and needy persons.
- Institutional credit has by-passed the weaker section of our society. Therefore making credit available and accessible remains crucial for long term development strategy to remove poverty.
- In some of the states of India, better rural the states of Bihar, Orissa and Assam. In wonders.
- According to a rough estimate, two-third of the credit need in rural areas is met out by informal sources for which high rate of interest varying from 36% to 120% per annum is charged by private money lenders. This is highly objectionable and causes problems. It is a social exploitation of the poor. Micro Finance if properly arranged can solve the problem under reference to a great extent.
- Our is a weak banking system which is unable to access the poor and needy people. The basic banking services are considered essential for the development of sustainable Micro Finance. Traditional banking institutions are not capable of providing Micro Finance services directly. Therefore, banking system needs strengthening.
- It is observed in the countryside that the officials have indulged in corrupt practices and create unnecessary problems for the beneficiaries of Micro Finance.
- There are some NGOs which do favour to particular persons having good relations with them but the genuine persons are ignored. Thus affluent persons get the benefits manipulated.
- The problems require appropriate and timely solution for revamping the working of MFIs and for providing timely services to the poor in need.

### Suggestions

For improving the system of Micro Finance following suggestions are given:

- To cope with the problems of Micro Finance, it is suggested that general awareness among the target group should be generated through interaction on the part of voluntary organisations and the developmental personnel. Demonstration can be arranged of SHGs as have achieved commendable success under Micro Finance Programmes. This will have direct impact on other prospective beneficiaries.
- The Fis must be encouraged for extending Micro Finance services. If some institutions face loss under Micro Finance, these should be compensated by way of special assistance on the part of RBI. The government should motivate new Fis with a supportive policy and financial resources to enlarge and expand their services.
- \*As there is lack of legislative support to properly regulate Micro Finance Programmes, therefore, the needed legislation should be passed and effectively implemented to regulate Micro Finance. Besides, the poor engaged in agriculture, allied activities and the non-farm sector should be encouraged.

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- The community based developmental, institutions should be promoted NGOs/MFIs and others to facilitate adoption of best practices for Micro-finance activities.
- There is a need for modification for the NABARD Act to legitimately bodies to finance MFIs as part of their regular operations and not as
- We "need removal of the government monopoly on establishing rural sector. The Regional Rural Banks Act should be amended to allow of RRBs.
- Better infrastructure should be made available to reduce potential risks and transaction cost for financial institutions and provide incentives to diversify and expand their operations.
- The government should focus its attention on supportive development of sound banking system to provide traditional banking services prior to the establishment of a formal Micro-Finance industry.
- Social audit should be conducted from time and again to ensure cent's satisfaction.
- To improve the working of bankers in favour of client, it would better if efforts are made to change the attitude of bankers through training and retraining. It is hoped that the measures suggested would prove useful in the strengthening of micro finance agencies/institutions.

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