**The Impact of Microfinance on Rural Development in India**

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**Abstract**

Microfinance is used to supply small credits to very poor section of society that is unable to access the traditional economical financial institutions such as banks. It helps them in acquiring finance to expand their tiny businesses and other financial needs. Microfinances also help in improving the contribution of women in economic activities by providing economical resources to invest. This research paper is an effort to bring light the role of microfinance in rural development through the study of micro financial schemes. We can learn important lessons from microfinance for developments in terms of what can be the strategy that we can adapt to make a difference. We can conclude that weak sector of Indian economy is in dire need of money lending methods to earn credits so microfinance programs should be an important area of focus to provide the people the chance to improve their standard of living via means of economical growth.

**Keywords:** microfinance, money lending, rural development, financial planning etc.

1. **INTRODUCTION**

The weaker section of Indian economy uses their resources to develop. Their businesses and their homes slowly over time. Financial services enable the poor to take advantage in this Initiative, accelerate the construction of revenue in the process, assets and economic security. However, conventional financial institutions rarely lend bottom of the market to serve needs of low-income families and women-headed households. They are often denied access to credit for what purpose, making the debate about the level of interest rates and other conditions relevant funding. Therefore, fundamental problem is not unaffordable terms but lack of access to credit itself.

Also when we talk about rural development, if the credit infrastructure grows, credit flows to the poor. As a result National Bank for Agriculture and Rural Development (NABARD) was set up with the objective of framing appropriate policy for rural credit, provision of technical assistance backed liquidity support to banks, supervision of rural credit institutions and other development initiatives. So it was experienced that existing policies were inefficient in the ways of procedures, deposits and loan products. The poor needed better access to all these services and also all these products. If anyone feels that an institution is unfriendly and uncaring in its behavior towards its customers, they hesitate in dealing with them. More importantly, if a persona doesn’t have any security to offer in return of credit, even though he is sure in paying the credit back, legal financial institutions can’t help even the promising customer due to its rules and regulations. The lack of access to credit for the poor is attributable to practical difficulties arising from the discrepancy between the mode of operation followed by financial institutions and the economical characteristics and financing needs of low income households.
However, many attempts are being made in the last decade to improve the microfinance for rural economy. Successful experiences in providing finance to small entrepreneurs and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, repay their loans and use the proceeds to increase their income and assets. This is not surprising since the only realistic alternative for them is to borrow from informal market at an interest much higher than at market rates. Community banks, NGOs and grass root savings and credit groups around the world have shown that these micro enterprise loans can be profitable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

Table-1 : Microfinancial Plans and needs in rural economy

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Loan/Deposite</th>
<th>Plans</th>
<th>Reasons/needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Deposit</td>
<td>Insurances, pension plans and other long term deposits like F.D.s</td>
<td>Retirement, savings, homes, irrigation and agricultural facilities, accidental and health insurances, traditional and social requirements.</td>
</tr>
<tr>
<td>2.</td>
<td>Deposit</td>
<td>Medium and short term deposit</td>
<td>Food and health security, festivals and celebrations, cultural functions, irrigation and livestock needs, education, transportation etc.</td>
</tr>
<tr>
<td>3.</td>
<td>Loan</td>
<td>Emergency Loans</td>
<td>Sickness, crop failures, natural calamities, getting rid of money lending cycles from informal moneylenders.</td>
</tr>
<tr>
<td>4.</td>
<td>Loan</td>
<td>Short term and long term loans</td>
<td>Housing, home equipments, purchasing agricultural land and resources, Livestock and transformational needs etc.</td>
</tr>
</tbody>
</table>

2. HISTORY OF MICROFINANCE

Due to the large population of around 1250 million, India’s GDP is among top 20 economies of the world, but around half of these people are living under poverty line. Hence microfinance is very significant to Indian economy.

In early 1970s of Indian subcontinent, mainly in India and Bangladesh, Microfinance came into existence by the initiatives of microfinance pioneer Muhammad Yunus of Bangladesh. Microfinance in India came into strength with the formation of Shri Mahila “SEWA” Sahakari Bank, (Self Employed Women’s Association) in the state of Gujarat with the motive of providing financial help to poor women employed in the unorganized sector in Amdavad.

With globalization and Liberalization of the economy, opportunities for the unskilled people are not improving with sufficient rate as compared to the rest of the economy. So in this context micro financial institutions are significant and gaining its role in Indian economy.

2.1 The existing Informal Financial sources

The informal financial sources generally include funds available from family sources or local money lenders. The local money lenders charge exorbitant rates, generally ranging from 36% to 60% interest due to their monopoly in the absence of any other source of credit for non-conventional needs. Chit Funds and Bishis are other forms of credit system operated by groups of people for their mutual benefit which however have their own limitations.

Commercial and cooperative banks, SIDBI etc. get involved in microfinance on a large scale, as given by National Banka for Agriculture and Rural Development (NABARD) 2013 report, in table 2.
Most of the NGOs like SHARAN in Delhi, FEDERATION OF THRIFT AND CREDIT ASSOCIATION (FTCA) in Hyderabad or SPARC in Bombay have adopted the first model where they initiate the groups and provide the necessary management support. Others like SEWA in Ahmedabad or BARODA CITIZEN’s COUNCIL in Baroda pertain to the second model.

The experience of these informal intermediaries shows that although the savings of group members, small in nature do not attract high returns, it is still practiced due to security reasons and for getting loans at lower rates compared to that available from money lenders.

3. STRENGTHS OF INFORMAL SECTOR

A synthesis that can be evolved out of the success of NGOs/CBOs engaged in microfinance is based on certain preconditions, institutional and facilitating factors.

(a) Preconditions to Success: Those NGOs/CBOs have been successful that have financial value/discipline through savings and have demonstrated a matching value themselves before lending. A recovery system based on social intermediation and various options including non-financial mechanisms has proved to be effective. Another important feature has been the community governance. The communities in which households are direct stakeholders have successfully demonstrated the success of programs.
(b) Operating Indicators: The operating indicators show that programs which are designed taking into account the localized and geographical differences have been successful. Effective and responsive accounting and monitoring mechanisms have been an important and critical ingredient for the success of programs. The operational success has been more when interest rates are at or near market rates: The experience of NGOs/CBOs indicates that low income households are willing to pay market rates. The crucial problem is not the interest rates but access to finance. Eventually in absence of such programs households end up paying much higher rates when borrowing from informal markets.

(c) Facilitating Factor: Another factor that has contributed to the success is the broad environment. A facilitative environment and enabling regulatory regimes contribute to the success. The NGOs/CBOs which have been able to leverage funds from formal programs have been successful. An essential factor for success is that all development programs should converge across sectors.

4. EFFECT ON POVERTY

The Biggest Irony in today’s world is that the producer of most important human asset, food, lives in rural Area and struggles to put food in their own children’s mouth.

India has over 25% of its population below poverty line. According to the world bank, India is home to around 300 million poor by Indian standards and around 400 million by international standards. Rural area is home to one third of India’s poor which is supported by the increasing urban and rural disparities.

Our traditional financial institutions like banks rarely lend money to the low-income families to serve their financial needs. The income of many low income households is not stable either. Smalla loans in large numbers is required for the special condition of Indian economy by ironically moneylenders prefer to give large loans in small numbers for reduction in administration and maintenance cost. Moneylenders also expect guaranteea in return of loan which is not possible for the case of loan to weaker section of Indian economy.

Over the last ten years, however, successful experiences in providing finance to small entrepreneur and producers demonstrate that poor people, when given access to responsive and timely financial services at market rates, pay back their loans and use the profits to increase their income and assets. This is not shocking since the only realistic alternative for them is to borrow the money from informal market. Community banks, NGOs and credita groups around the world have shown that these microenterprise loans can be proable for borrowers and for the lenders, making microfinance one of the most effective poverty reducing strategies.

5. MICROFINANCE AND SELF HELP GROUPS (SGHs) FOR RURAL DEVELOPMENT

There are two common approachesA of Micro Finance India - The Self help groups method and the Grameen system. An SHG is an unofficial group of approximately 10-20 members. The members of the SHG are joined for the specific purpose of facilitating saving and credit services for its members. This is made possible through members pooling their resources to create a common fund. The process and social involvement of SHGs are intended to be instruments of empowerment, building the capacity of members to eventually conduct and manage SHGs for themselves, and enabling them to have greater autonomy in financial decision making as well as wider social participation. SHG meetings are set to take place at regular intervals and at a designated time. Group members are drawn from the same socioeconomic layer and work on the basis of equal participation and contribution from all members.

The groups are chaired by one lead member at a time; this role is usually rotated to allow capacity building for all members. Meetings are structured and accurate and up to date recorda of all financial transactions, group decisions and actions are compiled. Once established, SHGs are encouraged to make links with other SHGs and eventually with
financial institutions to allow access to further financial assistance.

6. WEAKNESS OF EXISTING MICROFINANCIAL MODELS

The MFIs have successfully served the rural poor with no physical collateral relying on group responsibility to replace the collateral requirements. However,

- It involves too much of external subsidy which is not replicable. MFIs have not oriented themselves toward mobilising peoples’ resources.
- The repayment system of limited timed equal instalments is not practical because poor do not have a stable job and have to migrate to other places.
- Most of the existing microfinance institutions are facing problems regarding skilled labour which is not available for local level accounting. Drop out of trained staff is very high.
- Current system lack in appropriate legal and financial structure. There is a need to have a sub-group to brainstorm on statutory structure/ ownership control/ management/ taxation aspects/ financial sector prudential norms. A forum/network of micro-financier (self regulating organization) is desired.

7. REMEDIES

The problema of poverty, unemployment and illiteracy is prominent in rural India. Rurala population gets misled by informal moneylending and thus helpa in economic halt of the nation.

- The apparent solution to this problem seems that: it is very critical to link poor to formal financial system, awhatever the mechanism may be, if the goal of poverty alleviation has to be achieved.
- It is desired that an intermediary institutiona is required between formal financial markets and grassroot. The intermediary should encompass the strengthsa of both formal financial systems and NGOs and CBOs and should be flexible to the needs of endaa users.

8. CONCLUSION

The MFIs are a huge factor in impactinga India’sa social and economical development. Microfinance provide both savings and aloan facilities. MFI are the main source of loans to potential rural entrepreneurs of India. Also it is anticipated thata the people would become socially more advanced as they come intoa touch with the outside world. In order to be sustainable, microfinance lending should bea fixed on market principles because large scale lending cannot be completed througha financial support.

A core conclusiona of this paper is that microfinance can contribute into solving thes problem of insufficienta housing and rural services as an integral parta of poverty alleviation programs. Eventuallya it would be ideal to improve the creditworthinessa of the poor and to make them more bankable to financial institutions aand allow them to meet athe criteria for long-term credit from the formal asector.

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