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Microfinance as Alternative to Rural Credit Market in India

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ABSTRACT

Formal credit institutions face the problem of lenders risk in the absence of any collateral, problems of targeting, screening, monitoring and ensuring productive usage of loans along with high transaction cost. Hence, a large section of the rural poor has to remain outside the purview of formal sector lending. It is forced to depend upon non-institutional sources of credit like moneylenders, landlords, employers, friends and relatives, who often charge exorbitant interest rates. Thus, large scale indebtedness and poverty among rural people often stems from this rising dependence on informal lending institutions. Hence, microfinance can play an important role as there is a crucial need to make credit an integral part of poverty alleviation programme.

Keywords: Microfinance, Self Help Group, Rural Sector, Credit, Women.

Introduction

Credit plays a very important role in the livelihood of poor people. With large scale unemployment and ownership of land and other assets being highly skewed in favor of the rich, borrowing for consumption and production for the vast rural masses becomes very important. Formal credit institutions face the problem of lenders risk in the absence of any collateral, problems of targeting, screening, monitoring and ensuring productive usage of loans along with high transaction cost. Hence, a large section of the rural poor has to remain outside the purview of formal sector lending. It is forced to depend upon non-institutional sources of credit like moneylenders, landlords, employers, friends and relatives, who often charge exorbitant interest rates. Thus, large scale indebtedness and poverty among rural people often stems from this rising dependence on informal lending institutions. Hence, there is a crucial need to make credit an integral part of poverty alleviation programme.

As is well known, the financial sector reforms since the liberalization of the 1990s have led to a gradual withdrawal of the state from the provision of rural credit in India. Thus, to fill in the gap,

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

RBI and NABARD introduced microfinance to ensure easy access to credit in areas marked by the absence of institutional sources of financing. Two broad approaches characterize the microfinance sector in India first, self-help group (SHG)-bank linkage [this model involves the SHGs financed directly by the banking agencies viz. Commercial Banks (Public Sector and Private Sector), Regional Rural Banks (RRBs) and Cooperative Banks] and second, MFI Bank Linkage Model: under this model, Micro Finance Institutions (MFIs) avail bulk loans from banks for on-lending to SHGs and others small borrower. (NABARD, 2006-07). In 1992, NABARD after a pilot project took the initiative to link the formal credit institutions with SHG and microfinance institutions. In sharp contrast to several other developing countries where microfinance is a parallel banking system, in India, the key element of the sector is that it is a bank led programme.

With 75 percent of the world's microfinance borrowers based in Asia in 2010, it is a well-known fact that Asia has been leading the global exposure to microfinance. (Microfinance Information Exchange, 2012). Furthermore, it has been estimated that in 2011, India alone gave out $4.3 billion as loans to around 26.4 million borrowers, ninety percent of whom were concentrated in the two states of Andhra Pradesh and Tamil Nadu (Ghosh, 2013).

Literature Review

The poverty alleviating impact of microfinance in developing countries of Asia, Africa and Latin America has been a widely researched area. In this regard, a number of studies have suggested that microfinance has a significant impact on poverty reduction as well as household wellbeing at different levels such as asset acquisition, household nutrition, health, food security, children's education, women's empowerment, and social cohesion (SIDBI, 2008, Puhazhendi and Satyasai 2000 Puhazhendi and Badatya, 2002, Burgess and Pande, 2005). Yet, other studies show that the achievements are only partial and contested (Ghosh, 2013, Bateman and Chang, 2012, Chavan and Rama Kumar, 2002, Swaminathan, 2007), even as some recognize the beneficial role of MFI but argue that microfinance does not assist the poorest (Hulme and Mosely, 1996, Jayaraman, 2001, Choudhary, 2009).

It has been argued that the strength of microfinance sector lies in the fact that it makes credit available without any need for collateral, thereby providing hope to the large number of the rural poor who earlier did not have access to credit. Thus, microfinance has been seen as supplementing banks efforts to reach out to the poor in a cost-effective manner since the nineties (Jayaram, 2002).

Given the urgent need to address the problem of widespread poverty that prevails across the Indian countryside, it has been pointed out that exclusive reliance on microfinance, through

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

SHGs, may not suffice (Hulme and Mosley, 1998). Instead, it is often argued that the emphasis must be put on raising productivity of agriculture and generating non-farm employment. It is further pointed out that excessive focus on microfinance has diverted funding and support for small and medium enterprises which has significantly undermined the productivity and overall efficiency of India's economy (Karnani, 2011). The case of Andhra Pradesh has been cited as an example where the expansion of microfinance did not lift people out of poverty as it was often used to pay back existing loans, cover healthcare expenditures and meet immediate consumption needs rather than use it for productive investment (Taylor, 2011).

Thus, we have seen that the question of reducing rural poverty though microfinance has sparked a lively debate among policymakers and economists. Our aim here is to assess the claim that microfinance can be an effective alternative policy to address the problem of sustainable livelihoods and rural poverty through provision of credit.

Research Objective

Research objectives of the paper is as follows:

1. How has microfinance sector grown and progressed in India since its introduction in 1992?
2. To study the growth and effectiveness of microfinance institutions in alleviating poverty in India.
3. To assess the constraints and challenges of micro finance institutions in rural India.

Methodological outline to respond to the research question

We aim to use only secondary data sources to carry out our analysis using time series data.

Spread of Microfinance in India

India now boasts of some 14.5 million SHGs, of which 88 per cent are all-women-member ones. These groups usually consist of 20-25 members, mostly residents of villages. As we discussed earlier that there are two broad approaches that characterize the microfinance sector in India – self-help group (SHG)-bank linkage and MFI Bank Linkage Model. What started as a pilot to link around 500 SHGs of poor to the formal financial institutions during the year 1992-93 has now become the largest microfinance programme in the world. "Microfinance in its three-decade long journey has been a conduit to improved lives on account of better incomes for nearly a hundred million rural households. The sector has grown with regulatory prescriptions and policy interventions guiding the sector's growth journey" (NABARD, 2023). The Self-Help

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

Group Bank Linkage Program (SHG-BLP), is the largest microfinance programme in the world, in terms of the client base and outreach. The SHG movement, now in its 34th year, has emerged as a powerful intervention to cover the small and marginalized sections.

The pace at which microfinance paced in India is remarkable. Can be see form table 1, that total number of SHG who has bank credit increased from 637 in 1994 to 2238567in 2006 and 4295521 in 2022-23. Similarly, there was a vast increase in the amount of bank credit provided to SHGs during these periods from 80 lakhs to 1139750 lakhs in 2006 and 14520023 lakhs in 2022- 23. The ones who provide credit to SHGs are the three key institutions, namely, Commercial Banks, Regional Rural Banks and Cooperative Banks. Of all the three, commercial banks have been instrumental in providing bank credit to SHGs, 61.3 percent in 2006 and 64.11 in 2022-23.

Table 1

Self Help Group and Number of Bank Credit (Amount in Lakh)		
Year	**SHGs**	**Bank Credit**
1994	637	80
2000	263825	48090
2006	2238567	1139750
2022-23	4295521	14520023

Source: NABARD various issues.

Also, "16.19 crore rural households were covered under the SHG-BLP. A total of 134.03 lakh SHGs had savings linked to the banking sector with savings of Rs. 58,892.67 crore, registering growth of 13% and 25% over the previous year. Of these, 112.92 lakh were all women SHGs with savings of Rs. 52,455.48 crore accounting for 84% and 89% of total SHGs and savings, respectively". **"**The programme has empowered 144.22 lakh Self Help Groups (SHGs) and 17.75 crore rural households in India as on 31 March 2024. Nearly 54.82 lakh SHGs availed credit support of Rs.209285.87 crore from various banks during 2023-24, at an average of Rs.3.81 lakh per SHG. 73.34 lakh JLGs were promoted and financed by banks during 2023-24". (NABARD 2022-23).

At present, microfinance operations in the country are spread over 600 districts across 36 States/UTs. The microfinance penetration level is below 10% mostly in areas of J&K, coastal

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

Maharashtra, Western UP, Uttarakhand etc., while it is higher in Southern States such as Tamil Nadu, Karnataka, Kerala and Eastern States such as West Bengal, Odisha, Bihar, etc. Out of the 124 aspirational districts, microlenders are operating in 113 districts with microfinance penetration between 25%-50%.

Effectiveness of Microfinance Institutions

As per government record, SIDBI and NABARD, microfinance is providing microcredit to 6.6 Cr women in India. Recently Niti Aayog national poverty index of 2024 says that 13.5 crore people have escaped poverty between 2015-16 and 2019-21.

All India Debt and Investment Survey (AIDIS) in table 2 show that in 2006 people in rural India reported taking loans from moneylenders was 38.2 percent and from friends was 14.1 percent, though taking loans from friends could be interest free but taking loans from moneylenders would be high interest rate. On the other hand, taking loans from commercial banks were 21.5 percent and 26.1 percent from cooperatives. As per AIDIS data we can see that people were dependent on moneylenders and friends even after a decade.

In 2018, AIDIS data show that taking from money lenders and friends fell to 22.8 and 6.8 percent. Though the percent fell but didn't fall drastically. From Institutional agencies people taking loan from commercial banks increased by double to 41.9 percent by from cooperatives fell drastically to 9.9 percent.

Table 2

Percent of household reporting outstanding cash debt All India (Rural)

Credit agency	2006	2018
Commercial banks	21.5	41.9
Cooperatives	26.1	9.9
others	3.1	15.1
All institutional agencies	50.7	66.9
Money Lenders	38.2	22.8
Relatiive and friends	14.1	6.8
Others	6	4.2
Non-Institutional agencies.	58.3	33.8

Source: AIDIS
Note: the figures may not add up to 100 as there are households that have taken loans from multiple sources.

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

On the other hand, NABARD report of 2022-23 shows that a report published by Sa-Dhan on Impact Assessment study of clients of Microfinance Institutions (MFIs) conducted in 17 states of India during 2022-23 acknowledged that 46% of microfinance loans are provided to families having monthly income less than Rs. 20,000, i.e., servicing the population living in distress. Also, dependence on moneylenders reduced substantially, i.e., from 20.1% to 8.3% and brought deprived populations under institutional fold with gradual economic improvement. Further, the report says that 52% of loan utilisation is for working capital for their income generating activities and 31% of loan utilisation is for income generating assets including livestock. The first cycle of loan is used mostly for starting new enterprise and subsequent loans cycles are for working capital requirement.

Table 3 from AIDIS presents the percentage share of cash debt from different credit agencies by the purpose for which the credit had been taken.

Table 3

Percentage share of cash debt from different credit agencies by the purpose for which the credit had been taken.

Purpose of loan	**Institutional**	**Non-Institutional**
Capital expenditure in farm business	19.5	9.1
Revenue Expenditure in farm business	25	12
Capital expenditure in non-farm business	6.5	3.8
Revenue Expenditure in non- farm business	2.2	1.2
For Education	2.3	2.4
For Medical Treatment	1.8	10.1
For housing Expenditure	33.8	48.5
Others	8.9	12.9
All	100	100

Source: AIDIS , 2019

Households both from institution and non-institutional sources take loan for the primary purpose of housing expenditure. We can see from table 3 households took 33.8 from institutional sources and 48,5 from non-institutional sources. Households take loan from housing expenditure more from non-institutional source as its easy-to-get loan from there with less paper work and mortage

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

that non-institutional sources will accept. For taking loan for agriculture sector, households take 54.5 and 21.1 percent from institutional and non-institutional sources.

Table 4 show that 44. 9 percent of rural household in India reported loan outstanding from institutional sources at 10-15 percent per annum. Sometime households take loan from family members or from loan from moneylenders who do a lot of work for them may charge zero interest rate per annum, it can be seen that 20.2 percent of households have zero ROI.

Table 4

Percent distribution of outstanding cash debt by rate of interest (ROI)

	Rural	
ROI	**Institutional**	**Non-Institutional**
Nil	**1.3**	**20.2**
<6	6.4	1.6
6--10	39.2	0.8
10--15	44.9	4.2
15--20	5.2	5.5
20--25	2.3	44
25--30	0.3	0.3
30--50	0.2	18.7
50-100	0	4
> 100	0	0.5
All	100	100

Source : AIDIS 2018

18.7 percent of households from non-institutional source take interest rate at 50 per cent per annum.

NABARD is also saying that microfinance will achieve SDG goals as discussed below:

1. **No poverty**: Improved savings and capital formation helped members to improve self-financing capabilities and risk bearing ability. It was estimated that the proportion of members below poverty line declined from 58% in pre-SHG situation to 33% in post-SHG situation, likely due to income growth of 6% per annum.

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

2. **Zero Hunger**: Ending hunger and improving nutrition. Most SHG members take loans for crop/vegetable production and livestock rearing which improve and push domestic consumption. SHG loans are taken for consumption purposes to some extent to help tide over the shortfall in purchasing power due to seasonal cash in-flows.

3. **Good Health and wellbeing**: Empowerment means improved financial security, improved power relationships within households and society, enhanced awareness on health, increased contribution in household decision making along with men and acceptance by men and recognition to women. Safe deliveries and better focus on mother and child health can reduce maternal mortality. Further, the hygiene practices at household, community and village levels have changed for the better and women have increasingly benefited from other government schemes too.

4. **Quality Education**: SHG membership is known to have improved access to education. As per an empirical study on the impact of SHGs, around 80% of members reported an increase in access to education. Several SHGs demanded a school in the village, distributed books to poor children; proposed an English medium school and created awareness on the importance of educating girl child among parents through campaigns /discussions. Many SHGs discussed the importance of education in group meetings and held evening classes for members.

5. **Gender Equality**: Various studies have brought out that members of SHGs expressed better role in decision making at home and community, higher level of confidence in facing people outside one's home and situations, ability to raise voice on violence against self and fellow members and ensuring children’s education compared to non-members.

    • Around 98% of the MFI borrowers are women, and are playing an important role in mobilizing resources for the family to set up/run an enterprise.

    • Around 22% of the sample covered under the Sa-Dhan study mentioned that they are using UPI for cashless transactions, while 62% have their spouse or other family members using UPI services for cashless transactions.

6. **Decent work and economic growth**: SHGs promote decent work and economic growth by creating employment opportunities and enhancing productivity for their members. They also foster innovation and diversification in the rural economy by supporting various sectors such as agriculture, handicrafts, food processing, diary, poultry, etc. SHGs also facilitate linkages with government schemes, banks, NGOs and private sector partners for accessing resources and opportunities.

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

Action to Bridge the Gap as per NABARD

Covering all eligible families under SHG-BLP: As per Socio Economic and Caste Census (SECC) Data on Rural Households (HH) in the country, there are 17.97 crore Rural Households (2011), of which 13.40 crore households have a monthly income of the highest earning member in the family at less than Rs. 5000. All these HHs are economically backward and constitute potential for SHG formation. In absolute terms, SHG-BLP has covered 16.19 crore households, apparently leaving no further scope for SHG formation. However, this has happened as major states like Odisha, Maharashtra, all the five southern states and Assam have exceeded the targeted population. Based on the balance potential available in other states, there is scope of formation of 18.60 lakh SHGs to target all families in rural areas under low-income bracket. Considering the SHG growth rate over the last three years of 6.47%, the target for SHG formation would be achieved well before 2030. The movement is mainly operationalized by NRLM and hence, their role is crucial in this direction

Minimizing Credit Gap and Regional Imbalances

The existing credit gap in SHG-BLP is 48.1% i.e. 64.46 lakh SHGs are yet to be credit linked. Over the last three years, credit linkage grew at 7.52%. The number of SHGs having loan outstanding by the end of 2030 is estimated at 115.57 lakh (46 lakh SHGs can be added). In order to credit link all the existing SHGs and to credit link new SHGs, there is a need to intensify the existing growth rate.

• Sustained policy support and patronage of SHG-BLP by state governments, as evidenced in the southern states, may be suitably replicated in other states.

• Role of banks is crucial and calls for regular sensitization and capacity building of bank staff and monitoring

at all levels.

• To facilitate credit linkage, NRLM, CBOs, SHG Federations, etc., have to ensure the quality of SHGs.

Transforming SHGs into Micro entrepreneurs

To help SHG members graduate into micro-entrepreneurs, the following need to be ensured.

a. Bank credit - ensuring frequency and amount.

b. Savings- products that suits SHG members and incentivise them to save additionally, alongwith creative mechanisms for sharing loans by members.

ISSN: 2455-8834

Volume:10, Issue:01 "January 2025"

c. Micro-infrastructure that can render small investments viable and fructuous.

d. Convergence across programmes and processes that dissipates less of energy, resources and efforts.

e. A loan can only take a business so far.

Like any start-up, women SHGs require skill-based training and administrative help to build successful businesses.

In its Financial Inclusion Programme (2020-24)

The Reserve Bank of India stressed on digital penetration for speedy financial inclusion. In terms of digital financial inclusion, two significant aspects are necessary to be mentioned. One is the digital recording of financial services and databases and the other is facilitating digital transactions through various modes. Both aspects are interdependent and to achieve the aim of transparency and financial inclusion, the synergy between these two is essential.

Concluding Observations

We can conclude about the spread and effectiveness of microfinance in India. It did spread rapidly in rural India starting from 1990s till 2024. Microfinance also provided microcredit to 6.6 Cr women in India. Data also showed that taking loan from landlords was declining. Microfinance loans were provided to families having monthly income less than Rs. 20,000, i.e., servicing the population living in distress. Loan utilisation was for working capital for their income generating activities and for income generating assets including livestock. It was also seen that households took loan from Institutional sources as at lower interest rate than non-institutional source.

Also, the microfinance penetration level is below 10% mostly in areas of J&K, coastal Maharashtra, Western UP, Uttarakhand etc., while it is higher in Southern States such as Tamil Nadu, Karnataka, Kerala and Eastern States such as West Bengal, Odisha, Bihar, etc. Action is taken by NABARD to Covering all eligible families under SHG-BLP. As per NABARD, 64.46 lakh SHGs are yet to be credit linked its argued that in order to credit link all the existing SHGs and to credit link new SHGs, there is a need to intensify the existing growth rate. Even though Microfinance is expanding and having effectives as far as poor is concerned, yet there are scopes to further strengthen it.

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Volume:10, Issue:01 "January 2025"

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