ISSN 2278 – 0211 (Online)

Role of Microfinance in the Development of Non-Farming Sectors

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Abstract:
Micro credit has been defined by the RBI as the provision of thrift, credit and other financial services to the poor in rural semi urban areas to enable them to raise their standards of living. It may cover not only consumption and production loans for various farm and non-form activities being pursued by the poor but also include their credit need such as housing. The micro credit supply must be seen as complementary to formal credit supply. Development of Non-Farm sector in rural areas enables us to use the unutilized labour-force productively in the rural areas, most of which cannot be moved away to urban areas. Non-farm activities also give fillip to other activities including agriculture through their forward and backward linkages, promoting a closer integration of agriculture and industry in the rural economy. Diversification of agriculture not only provides more employment to human labour but also increased productivity of land and labour.
Expansion of non-farm activities in rural area alone can arrest the large scale rural-urban migration. By localizing employment, they can bring down pressure on urban infrastructure. It is argued that in the case of distress diversification the level of rural agriculture wage rate relative to the agricultural wage rate should be lower. This is so because the workers without enough work in the non agricultural sector at lower wages. The empirical evidence of vaidyanathan however shows that the non-agricultural wage rate is in general higher than agricultural wages. Employment generation outside agriculture in a spatially dispensed manner holds the key to the strategy of poverty alleviation in the country. Of course, the state has to create an appropriate economic environment. Thus, the modernization process of rural economy would be incomplete without sustainable growth of non-farm sector in rural India. Micro finance has to play an important role in strengthening rural non-farm sector. Banks should think that small loans to poor are no longer a social obligation, but potential business opportunities.

1. Introduction

Micro credit has been defined by the RBI as the provision of thrift, credit and other financial services to the poor in rural, semi urban areas to enable them to raise their standards of living. It may cover not only consumption and production loans for various farm and non-form activities being pursued by the poor, but also include their credit need such as housing. The micro credit supply must be seen as complementary to formal credit supply. The collaboration and co-operation of the beneficiaries, especially at the repayment stage is ensured in this system. Majority of beneficiaries are women of developing economies who have proven themselves as better savers, better borrowers and better investors. NABARD provides refinance to banks participating in micro credit. NABARD treats the advances given by the banks to the groups as an advance to “weaker sections”. In India micro credit supply programme by linking self help groups with banks was launched by NABARD during 1992-1993 and has been closely monitored. The micro finance programme has shown good performance with respect to coverage, disbursement of credit and recovery rates acting as a beneficiary oriented scheme. NABARD had mentioned that while selecting a group for finance it should be seen that the group should not have come into existence solely for the purpose of obtaining loan, but should be a genuine need to help each other. Thus the aim should be to mobilize human resource.

Micro credit financing models were first initiated in the neighboring country of Bangladesh. Both among rural and urban poor almost 1/3 were hard-core poor at independence. The country witnessed simultaneously innovative and creative experimentations by the development activists. This ultimately led to the emergence of micro credit networking in rural Bangladesh considering the access to credit as one of basic human right. The micro finance institutions like Grameen Bank, Bangladesh Rural Advancement committee and other 5 private sector banks launched various development programmes of projects to serve specific clients. It ranged from literacy drive, health awareness and disaster management schemes.

Bangladesh Rural Advancement committee (BRAC) renders micro finance service. There the target households are those having less than 0.5 acres of land and main occupation is manual labour for more than 100 days per year. They discovered that in new lending methods; the rural poor not only made productive use of credit and enhanced their income levels but also repaid loans in time. Organizing the poor into groups appeared quite efficient. The groups provided an additional guarantee against default and convenient

mechanism to disseminate knowledge especially among women. The group formation is initiated by the institutions providing micro credit. They will select their area of operation and make some surveys to estimate the scope of launching their activities. In the next stage, village meeting could be held with active support of local leaders. In the third stage, small homogenous group consisting of 5 members from different families will form group and leader selected. Leader is entrusted with responsibility for group regarding co-ordination and timely meetings.
Initially the members are expected to make weekly savings of definite amount and once they complete the stipulated period of compulsory savings, they become eligible for credit support. For 15-20 groups a village field worker was provided. The transactions in terms of savings deposit, repayment and loan issue were carried out in the group meetings and personal visit to banks by the field worker. The staff of the centre and branch would also make rounds in various meetings to make random check and provide necessary supervisory assistance to the group. On recommendation of the group members and also the concerned field workers, the loan application of member is forwarded to the branch for necessary action. If the amount was more, the time needed was two weeks. The last installments of large loans were released upon receiving satisfactory repayment of the first loan installments. In some institutions group loans were sanctioned and they decided who would be the first and subsequent beneficiary.

2. NABARD Specifications

- Regarding size of group: The group size is preferably between 10&25 members to enable effective individual participation in the group's activities. Large groups must prove their democratic and participatory conduct of activities.
- Purpose of loans: The purposes for which the group will lend to the members should be left to the common wisdom of group.
- Repayment installments: The SHG would be free to prescribe appropriate repayment period and terms for loans to members as determined by the group.

3. Advantages

The flexibility aspect: The branch managers have the power to make decisions regarding the SHGs to make the linkage between poor and formal credit system flexible. The bank provides credit in bulk directly to the group and group in turn would undertake decision on lending to the members. SHG should be willing to accept the responsibility of proper activities through credit utilization and repayment by the members. The SHGs are formed related to specific production activities. They lead to mobilization of savings among members who could normally not be expected to have any savings. These savings function as security to get credit for needs of members. The democratic functioning enables cohesiveness, location of the real beneficiaries by appraising of credit needs of member, their business like functioning and in recycling of funds and cent percent repayment rates are additional welcome features.
Other advantages expected include the much needed solution to the twin problem faced by banks. Recovery of loans in the rural areas and high transactions cost in dealing with small borrower at frequent intervals. Thus their out-reach to unserved rural people through a net of credit needs. A larger mobilization of small savings would enable a wide coverage of target group. To groups, access to amount of resources, skill upgradation and economic security is made sustainable. Informal group guarantee is the hidden collateral in the banks. The amount of weekly repayment would be fixed, depending upon the size of the loan amount and the installments. The repayment performance in the case of selected micro finance institutions was observed to exceed 95-98% for all types of credit products. The loan is taken for a wide range of economic activities such as vegetable cultivation, rice husking, mulch cattle, calf rearing, land mortgage, sanitation, water supply, house construction. Maintenance of assets created and income generation was enabled and weekly payment was convenient as the earning was mostly out of the borrowed fund. Thus the members joined the development stream.

4. Need of Rural Non Farm Sector

Non-Farm rural employment has many advantages. Development of Non-Farm sector in rural areas enables us to use the unutilized labour-force productively in the rural areas, most of which cannot be moved away to urban areas. Non-farm activities also give fillip to other activities including agriculture through their forward and backward linkages, promoting a closer integration of agriculture and industry in the rural economy. Diversification of agriculture not only provides more employment to human labour but also increased productivity of land and labour.
The rural non-farm sector in most developing countries can:

i. Lower unemployment by absorbing the growing labour force.
ii. Reduce rural urban migration.
iii. Employ women and provide seasonal employment or residential employment for those left out of agriculture.
iv. Use more appropriate technology.
v. Improve household security through diversification.
vi. Produce commonly produced goods at lower cost.
vii. Promote a more equitable distribution of income

Expansion of non-farm activities in rural area alone can arrest the large scale rural-urban migration. By localizing employment, they can bring down pressure on urban infrastructure. It is argued that in the case of distress diversification the level of rural agriculture wage rate relative to the agricultural wage rate should be lower. This is so because the workers without enough work in the non agricultural sector at lower wages. The empirical evidence of vaidyanathan however shows that the non-agricultural wage rate is in general higher than agricultural wages. Employment generation outside agriculture in a spatially dispensed manner holds the key to the strategy of poverty alleviation in the country. Of course, the state has to create an appropriate economic environment. Thus, the modernization process of rural economy would be incomplete without sustainable growth of non-farm sector in rural India. Micro finance has to play an important role in strengthening rural non-farm sector. Banks should think that small loans to poor are no longer a social obligation, but potential business opportunities.

5. Progress of SHG Bank Linkage

Micro credit or micro finance is a “Novel approach to banking with the poor”. In this approach, very successfully tried in Bangladesh, bank credit is extended to poor through SHGs, NGOs, credit unions etc. Micro credit attempts to combine lower transaction costs and high degree of repayments. This is essentially because of the involvement of potential beneficiaries of rural credit in the credit delivery system. The SHG-Bank linkage programme, introduced and encouraged by NABARD, is now being implemented vigorously by more than 30,000 branches of commercial banks, RRBs and Co-operative banks in over 520 districts in 30 states and Union Territories.

6. Weakness of Microfinance

Despite significant progress of Micro finance on Micro credit programme in the country, there are some issues of concern. Out of an estimated 56 million poor families at the end of March 2010 (this meant that at the average rate of 5 persons to family, there were 260 million poor in the country at the end of March 2004) only 17 million poor families or 30% of the poor families have been covered by Micro finance schemes. Nearly 70% of poor non farming sector families are yet to be covered. At present, Andhra Pradesh accounts for 40% of SHGs linked to bank credit. The next 3 states, Tamil Nadu, Karnataka, and Uttar Pradesh together accounted nearly 30% of SH groups linked to bank credit. Thus, only 4 states in the country account for 70% of SHGs linked to bank credit and 80% bank loans. In other words, most states in the country have not yet encouraged the organization and promotion of SHGs-bank credit link. RBI has been making efforts to give a fillip to micro finance initiatives through creating an enabling environment. It is looking in to issues relating to creating an enabling environment.

i. Structure and sustainability
ii. Funding
iii. Regulation and capacity building of Micro Finance institution.

7. Conclusion

One thing is very clear. The non-farm employment should lead to agricultural prosperity. We have to create conditions contributing to this. A rise in non-farm employment because of diversification does not deliver the goods. After the pioneering efforts of the last 10 years, the development of non-farm sectors has reached tremendous level with the help of micro finance. With some more efforts substantial progress can be made in talking macro finance movement to the orbit of sustainability.

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