

# Micro Credit System as an Alternative Source of Credit for Rural Poor in India – Field based Evidences

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According to Reserve Bank of India, we are having 1,32,700 branches of banks in our country by March 2016, an average covering 14000 population per branch (RBI Report), out of it 86425 branches (65.12%) are in rural and semi urban areas. But, this big banking network is unable or reluctant to meet the credit requirement of rural communities, especially the poor and poorest of the poor. With this background, a study was conducted in three states namely Tamil Nadu, Karnataka and Odisha, the field based evidences are presented in this paper. The status analysis of performance level and problems faced for obtaining loans by the poor people with the formal banks and factors attracted towards informal sources of credit have been analysed. A number of parameters related to banking financial services process of the different sources of credit used and opinion were presented in this paper for better understanding of the readers and policy makers.

## I. Introduction

It is evident from various literatures; finance is an essential input for the rural community for their survival and development. According to Reserve Bank of India, we are having 1,32,700 branches of banks in our country by March 2016, an average covering 14000 population per branch (RBI Report), out of it 86425 branches (65.12 %) are in rural and semi urban areas. but it unable to meet the credit requirement of rural communities, especially the poor and poorest of the poor. The present scenario of the upcoming Micro Financing Institutions is meeting the dire need of rural people's credit. This paper is prepared based on the responses from the field namely Tamil Nadu, Karnataka and Orissa, data were collected from the borrowers of different sources in selected region. The opinion on various parameters listed in the tables presented statewide are reflects the experiences of the borrowers with different sources. In each state 100 borrowers, 50 each from formal and informal sources were selected. The strengths and weaknesses of rural credit through formal source of banks and informal sources of Micro Financing Institutions (MFIs) are presented. The figures presented in the table are the responses of the borrowers of different sources. The figures in parenthesis represent the percentages of responses. The responses were collected based on three point scale namely 'Very Good', 'Good' and 'Bad' and the results are presented.

**Table 1. Strengths and Weaknesses of Formal and informal credit sources in Tamil Nadu**

Particulars	Formal Sources			Informal Sources		
	Very good	Good	Bad	Very Good	Good	Bad
Awareness on schemes availability		6 (12)	44 (88)		42 (84)	8 (16)
Approachability		16 (32.0)	34 (68.0)	36 (72.0)	14 (28.0)	
Nearness of the source	18 (36.0)	22 (44.0)	10 (20.0)	50 (100)		
Timely allotted to borrowers			50 (100.0)	50 (100.0)		
Mediator		11 (22.0)	39 (78.0)		50 (100.0)	
Application Process		17 (34.0)	33 (66.0)	50 (100.0)		
Documents requirement		21 (42.0)	29 (58.0)	40 (80.0)	10 (20.0)	
Collateral security		13 (26.0)	37 (74.0)	45 (90.0)	5 (10.0)	
Guarantee requirement		8 (16.0)	42 (84.0)		50 (100.0)	
Duration for sanction		11 (22.0)	39 (78.0)	50 (100.0)		
Transparency			50 (100.0)	10 (20.0)		

Administrative cost		16 (32.0)	34 (68.0)	5 (10.0)	45 (90.0)	
Response on loan request			50 (100.0)	50 (100.0)		
Quantum of loan			50 (100.0)			
a. Minimum				42 (84.0)	8 (16.0)	
b. Maximum		50 (100.0)			12 (24.0)	38 (76.0)
Rate of interest	50 (100.0)				12 (24.0)	38 (76.0)
Mode of re-payment		38 (76.0)		32 (64.0)	18 (36.0)	
Flexibility of re-payment	27 (54.0)	23 (46.0)			16 (32.0)	44 (88.0)
Subsidy	29 (58.0)	19 (38.0)	2 (4.0)			50 (100.0)
Action against defaulters	50 (100.0)					50 (100.0)
Second loan			50 (100.0)		36 (72.0)	14 (28.0)
Follow-up			50 (100.0)		18 (36.0)	32 (64.0)

**Table 2. Strengths and Weakness of Formal and informal Credit Sources in Karnataka**

Particulars	Formal Sources			Informal Sources		
	Very good	Good	Bad	Very Good	Good	Bad
Awareness on schemes		15 (30.0)	35 (70.0)		30 (60.0)	20 (40.0)
Approachability		8 (16.0)	42 (84.0)	50 (100.0)		
Nearness of the source		16 (32.0)	34 (68.0)	50 (100.0)		
Timely availability to consumers	50 (100.0)			50 (100.0)		
Mediator			50 (100.0)		50 (100.0)	
Application Process			50 (100.0)	50 (100.0)		
Documents requirement			50 (100.0)		36 (72.0)	14 (28.0)
Collateral security		10 (20.0)	40 (80.0)		36 (72.0)	14 (28.0)
Guarantee requirement			50 (100.0)		50 (100.0)	
Duration for sanction			50 (100.0)	50 (100.0)		
Transparency					50 (100.0)	
Administrative cost		10 (20.0)	40 (80.0)		30 (60.0)	20 (40.0)
Response on loan request		10 (20.0)	40 (80.0)	10 (20.0)	40 (80.0)	
Quantum of loan						
a. Minimum		20 (40.0)	30 (60.0)	20 (40.0)	30 (60.0)	
b. Maximum	35 (70.0)	15 (30.0)				
Rate of interest	50 (100.0)				15 (30.0)	35 (70.0)
Mode of re-payment		32 (64.0)	18 (36.0)	37 (74.0)	9 (18.0)	4 (8.0)
Flexibility of re-payment	50 (100.0)				14 (28.0)	36 (72.0)
Subsidy	50 (100.0)					50 (100.0)
Action against defaulters	50 (100.0)					50 (100.0)

Second loan			50 (100.0)	28 (56.0)	13 (26.0)	9 (18.0)
Follow-up			50 (100.0)	36 (72.0)	7 (14.0)	7 (14.0)

**Table 3. Strengths and Weakness of Formal and informal Credit Sources in Orissa**

Particulars	Formal Sources			Informal Sources			
	Very good	Good	Bad	Very Good	Good	Bad	Very Bad
Awareness on schemes			50 (100.0)		50 (100.0)		
Approachability		23 (46.0)	27 (54.0)	14 (28.0)	36 (72.0)		
Nearness of the source			50 (100.0)	50 (100.0)			
Timely availability to Consumers			50 (100.0)	50 (100.0)			
Mediator	10 (20.0)	17 ( )	23 (46.0)		50 (100.0)		
Application Process			50 (100.0)	50 (100.0)			
Documents requirement			50 (100.0)	50 (100.0)			
Collateral security			50 (100.0)	50 (100.0)			
Guarantee requirement			50 (100.0)	50 (100.0)			
Duration for sanction		29 (58.0)	21 (42.0)	50 (100.0)			
Transparency			50 (100.0)	30 (60.0)	20 (40.0)		
Administrative cost		23 (46.0)	27 (54.0)	16 (32.0)	14 (28.0)	20 (40.0)	
Response on loan request		38 (76.0)	12 (24.0)		19 (38.0)	31 (62.0)	
Quantum of loan							
a. Minimum			50 (100.0)	35 (70.0)	15 (30.0)		
b. Maximum		41 (82.0)	9 (18.0)	35 (70.0)	15 (30.0)		
Rate of interest	50 (100.0)				34 (68.0)	16 (32.0)	
Mode of re-payment		23 (46.0)	27 (54.0)	35 (70.0)	15 (30.0)		
Flexibility of re-payment	50 (100.0)				10 (20.0)	40 (80.0)	
Subsidy	50 (100.0)					50 (100.0)	20 (40.0)
Action against defaulters	50 (100.0)				30 (60.0)	20 (40.0)	
Second loan before completion of first loan			50 (100.0)		30 (60.0)	20 (40.0)	
Follow-up		16 (32.0)	34 (68.0)		30 (60.0)	20 (40.0)	

## II. Awareness of the availability of Schemes

The banks are having a number of schemes for the benefit of customers as well as bankers. But, these are not sufficiently made known to the general public; not only to the general public but also to the account holders. Even the highly educated people are not aware of the various schemes available from banks. Public and private sector banks are having only very few schemes as far as the rural poor are concerned; these are again due to the government's compulsion. The government subsidy schemes are also availed by the rural land-lords and rich in rural areas, violating the stipulated eligibility criteria. The poorest of the poor do not get sufficient

opportunities to know about or avail the schemes. The commercial bank personnel are not much interested in taking appropriate measures for the inclusion of the poor in the banking transactions due to less repaying capacity.

### III. Approachability

Meeting the bank officials is an uphill task to the rural poor for any transaction in the bank. Plight of rural people's economic condition and the physical appearance does not please the bankers. In a majority cases, if at all, if a villager wants to make a transaction or to know about the bank's schemes, he or she should necessarily accompany along with an educated person or a middleman. It will be an unpleasant situation even for lower officials of banks to meet poor people. They never encourage poor people meeting the higher officials of the bank at any point of time. However, in the case of non-formal Micro Finance institutions, the poor are considered as assets for them. The MFIs go to the poor people's door step, and meet them as per their convenient time and convenient way with the objective of helping them. The poor are having full confidence in the MFIs, and also other forms of informal small credit institutions.

### IV. Nearness of the Source

The credit delivery source's location is also a matter affecting the service of banks. Even though, after many decades of efforts of linking all villages with the banking network, it is uphill task to cover majority of the smaller villages. Credit is still un-reached to many of remote villages. Now slowly, due to competition among bankers, private banks are coming forward to establish their branches in villages. However, all the available branches are concentrating only on preferred to lend for housing, industrial and service sector credit. The villagers like small and marginal farmers and agricultural labourers are unable to get, not only credit but also any other services from the nationalised as well as private sector banks because of the remoteness of the location of villages from bank branches.

### V. Timely availability of credit

This is the most important factor to be looked into seriously. In rural areas, people usually do not go to organised sources of credit. There is a general feeling among the rural masses that banks are not pro-poor. The banks always take months to decide and respond whether a particular person is eligible to get loan or not. Keeping this in view, people always borrow from the local money lenders or from relatives at high rate of interest. The people are less bothered about the rate of interest but are keen on finding solutions to their immediate problems as early as possible. The farmer cannot wait for months for credit to safeguard his crop; poor can't prolong their diseases; poor parents have to send their children to school; they have to get their daughters married when suitable occasion arises; the poor labourers have to feed their family during the slack agricultural season, etc. Timing of credit delivery is crucial for the rural masses. They may not be able to plan and keep money in advance to save their crops from pest attack, and other natural calamities. They need to take immediate measures to save their lives by safeguarding the agricultural crops and livestock. These constitute livelihood sources for them. The formal sources of bank credit would not be able to meet the urgent credit requirement of rural people due to the prevailing ambiguous and mountainous procedures. MFIs are serving the rural poor in a better way by providing credit adequately, timely, and with easy known processes. People prefer the MFIs to get quick remedies in credit delivery to overcome to their urgent problems.

### VI. Mediator Exploitation

In case of formal credit establishments, the mediators are exploiting the poor people by showing eagerness to help uneducated people in getting loan. Even, educated people are also running behind the brokers of banks to get things done. The general public are getting cheated easily due to the prevailing complexity of procedures, and lack of awareness among consumers. In majority of cases, the poor and especially women are the victims. Regarding release of loans in case of government subsidy based programmes, almost the total subsidy or a major portion of the subsidy goes to middlemen or bank brokers. It appears that, the bankers are encouraging the involvement of middlemen in the priority sector loans. Sometimes, the bankers ask the credit seekers to contact middlemen in which they also get commission. In real terms, the poor and uneducated are unable to fulfill the document requirements of the bankers. In the case of MFIs, the people themselves come forward and unite as groups to take credit from them. Every member shows keen interest in direct participation and involvement to ensure transparency in the transactions in their group. Everybody considers neighbor's problems as their own and share fellow feelings. In the group activities, cheating and exploitation are much less.

### VII. Application process

In the formal credit sources, existing cumbersome procedures and formalities, filling of many application forms, discourage people from approaching banks. Especially the rural poor uneducated masses hesitate to enter banking sector for obtaining loans. People who went to visit banks have to depend on intermediaries to get help in the submission of applications.

### VIII. Documents requirement

In case of formal sources, irrespective of the quantum of loan, loan seekers have to submit various documents. Even for the government schemes loans, it is essential to submit documents like nativity certificate, income certificate, copy of ration card, Photos, court fee stamps, project report, aadhar card and various legal undertakings, etc. Mobilising all these documents is unimaginable for the poor people. Even, if all the documents are mobilised and submitted, probability of getting loan is not always bright. Therefore, poor people hesitate to get into the formal sources of credit. But in the case of informal credit, no such documents are required, and the process is to be simplified.

### IX. Collateral Security and Guarantee

The RBI's directive clearly says that in case of loans up to rupees five lakhs; there is no need to submit any collateral security or guarantee to the banks. However, in reality, the banks hardly follow this rule. The bankers are hesitant to advance loan as they approached. It is true that they the failure of repayment higher authorities, regarding the loan disbursement and are accountable to realizing of repayment. However, if we see the quantum of loan from each bank provided to the industrial and services sectors becoming non-performing assets (NPA), it is very high, compared to credit to the poor in rural areas. Poor people may not have assets in their name and nobody can come forward to give guarantee for them. Even for people who have small assets, furnishing the document may be a problem like document may be in the joint name, if it is hereditary or legally not acceptable because of its nature. If the asset is a combined property, getting the written consent of all concerned will not materialise easily. In government schemes related loans also, in majority of cases people are asked to submit security, and guarantors are required to give undertaking. Moreover, loan seekers are asked to deposit some amount of money in fixed deposit or should have to keep huge amount in the savings account. Otherwise, the government subsidy is withheld as safety for repayment. This condition prevents asset less poor, and who are not able to find guarantor to avail the credit from the formal sources.

### X. Time taken for processing the request for loan

As discussed earlier, timely credit plays a pivotal role in the life of rural communities. In general, formal credit institutions are taking minimum one to two months for processing the loan application, which will not serve the purpose of rural communities. By nature it is very difficult for rural people to anticipate the financial requirement for their field operations. Less income of the poor leads to lack of money with them, and this will make them run behind the local money lenders, and payback as and when they get income during agricultural peak season. This places the poor in the vicious circle of borrowing. In informal credit sources like MFIs or other forms like chits, they take only hours or maximum a day to process and sanction the loan. The advantage of nearness is another factor attracting the poor people towards the informal sources of credit.

### XI. Cost of loan and Rate of Interest

Technical terminologies used by the bankers are not intelligible even to the well trained persons. People who have studied finance only can understand the details. They speak about fixed interest, floating interest, compound interest, diminishing rate of interest, etc. These are all not familiar to the common man. The poor borrowers only want to know whether the loan has got sanctioned or not, EMI amount and the repayment period. In the banks, they take processing charge of Rs. 2000/ per one lakh rupees. If we calculate the time cost, hidden cost, wage compensation cost, bribe or commission paid, cost involved in repayment, and the future value of present cost, the formal credit institution's 'rate of interest' may also be equally on par with the MFIs interest rate. MFIs are not only doing the lending service but are also helpful in the overall development of the beneficiaries. Some of the good Non-Governmental Organisation's MFIs, redistribute surplus on the social and health development of the people appreciating regular repayment by the borrowers. MFIs may also perform well, if they are given facilities, as provided to the banks by the government in the initial stages. If we calculate the overhead cost of the MFIs, it is very difficult for them to operate for lower interest unlike in case of banks. MFIs provide credit amount of very few thousands to each borrower; and therefore, they have to transact with a large number of people and in different locations with a large number of staff; whereas banks are operating in a fixed location with greater amount with few customers. For example, the bank provides loan of Rs. fifty lakhs to one borrower but for the same amount the MFIs have to transact at least with 1000 members of 100 villages with a loan of Rs 5000 per head. This is the way the volume of operations and the cost are very high for MFIs. If we compare this situation between banks and MFIs, one can say banks can reduce the rate of interest on loans.

### XII. Transparency of loan process

There is no transparency in the processing of credit application in the banking sector. Loan application status, processing fee calculation, deciding selection of type of interest and rate of interest are always gives ambiguity situation to the borrowers. The advanced banking system like e-banking, online transfer of money and payment of EMI are also not reached or explained to the rural customers who are predominantly illiterates.

### XIII. Quantum of loan

In rural areas, poor are starved for credit for getting a loan of very few thousands at a time. Right from the inception of the banking network, the banks have been discouraging the poor people for small credit. Poor man cannot think of money more than Rs. ten thousands. Very often, there is no necessity for them to ask for a huge amount. There are hardly any incidents of providing loan by the banks in small amounts of Rs. one thousand or less than Rs. five thousand. A poor vendor needs only a few hundred rupees to do his day's business. Suppose he takes more than that, he will spend the amount on non-investment consumption purposes. It will be an extra credit burden to him, which in turn puts him into troubles. Ultimately, the poor are neglected for small credit, and not made eligible for big loans from banks. But in MFIs, poor people are encouraged to avail only small amount of credit, subject to the repaying capacity of the individual.

### XIV. Mode and Flexibility of repayment

As far as the mode of repayment is concerned, in the context of the bank, the borrower has to go personally, and pay the dues within the prescribed period. MFI send its staff members to the borrower's door steps and collects whatever money beneficiary wants to repay. It is not compulsory for the borrower to pay back within the stipulated time and quantum of money, as in the case of a bank. In rural areas, repaying ability of the people will depend on the availability of work, and surplus out of income earned. The repayment period should match with the harvesting period. During the slack season, people find it difficult even to feed their family.

In such a situation, whatever pressure, the lender exercises for repayment, it will be of no avail. Compulsion will lead the client to borrow further from another source to clear the first loan. MFIs maintain flexibility in mode of repayment, quantum of loan and time.

#### XV. Action against Defaulters

This is the only area, where the banks are lenient in action against defaulters. Various research studies and statistics show that the repayment rate in rural areas is very high irrespective of the nature of sources. Various MFIs performance reports also show that their repayment rate is from 95 to 98 per cent. In majority of cases in rural areas, borrowers will not become willful defaulters until otherwise circumstances force them. Repaying dues is a prestige issue for rural people; they feel that action against default in front of fellow residents is shameful for them. The politicians are making village people as willful defaulters. People are very much aware of value of their right to franchise. The political parties, in order to capture poor people's vote bank, promise and waive the loan taken by the farmers and rural poor from banks. This makes every borrower to expect waiver of loans without having to repay in the near future. This tendency leads to non-repayment of loan even when they have the ability to repay.

#### XVI. Follow-up Action after Credit Delivery

Healthy credit and repayment requires follow up after sanctioning the loan. Experiences reveal that, the loan disbursed for income generating and productive purposes will be repaid in a proper manner. Majority of the commercial banks are not taking proper monitoring to verify whether the sanctioned loan is used for the approved purpose. This neglect by the bank personnel allows the borrower towards mis-utilisation of loan, leading ultimately to defaulting. Credit under government schemes also led to failure due to the absence of monitoring. Mere credit delivery will harm the lender-borrower relationship which finally results in dormant of the delivery mechanism. By noting this experience, in order to nourish the good environment for good credit, MFIs are giving much importance to pursue follow up monitoring mechanism. They also give guidance and capacity building in management of entrepreneurial activities.

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