Role of Microfinance Programs in Eradicating Social Exclusion- A Study on Indian States

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Abstract

The role of microfinance lies on the upliftment of socially and economically disadvantaged sections of the society by extending small savings, credit, insurance services to them. Consensus between exclusion and poverty has pointed out that lack of financial services is one of the principal constraints faced by the disadvantaged section of the population. In this paper an attempt has been made to analyze state specific progress under Microfinance over the years with econometric model. Since the microfinance programs are run by formal financial institutions with the help of SHGs, it is more likely that developed states having access to better formal financial institutions will have more Financial Inclusion through Microfinance programs. The papers tries to explore how much the backward states of India are getting benefits out of the Microfinance programs. For this, a linkage has been studied between Commercial Bank Network and number of Microfinance Institutions among the Indian States. The present paper attempts to analyze to what extent microfinance programs have succeeded towards ensuring equity in distribution of income or in reduction of poverty in the Indian states. The reason for regional disparity towards achievement of Financial Inclusion through Microfinance programs has also been explored in this study.

Keywords: *Exclusion, MFIs, Poverty, PCSDP, SHGs*

JEL Classification: *B23, G21*

Introduction

NABARD has defined microfinance as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban provided to customers to meet their financial needs; with only qualification that (1) transactions value is small and (2) customers are poor". According to the United Nations, microfinance associations can be widely portrayed as provider of little scope financial services, for example, investment funds, credit and other fundamental financial services to poor and low-earning people. The expression "microfinance establishment" alludes to a wide scope of associations committed to offering these types of assistance and incorporates NGOs, credit associations, co-agents, private business banks, NBFCs and parts of State-possessed banks.

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The microfinance has developed because of the endeavors of devoted people and financial organizations to advance self-employment and add to destitution mitigation and arrangement of standardized savings. India has had the option to build up its own model of microfinance associations as investment funds and acknowledge bunches known as the Self Help Group (SHGs), which are bank-connected. A SHG is a gathering of around 20 individuals from a homogeneous class, who meet up for tending to their normal issues. SHG-Banking is a program that assists with advancing financial transactions between the formal financial framework in India containing public and private sector commercial banks, regional rural banks and cooperative banks with the casual SHGs as customers. SHGs utilize the pooled asset together with the outer bank advance to give interest-bearing credits to their members. Such advance gives extra liquidity or buying power for use in any of the borrower's production, investment, or consumption activities. SHG-Banking through SHGs and the current decentralized conventional financial system including a few associations for the formal and non-formal areas as banking accomplices take into account enormous scope effort of microfinance services to the poor in India. These financial services are made accessible with ease, are effectively open and adaptable enough to address needy individuals' issues.

An enormous number of the poor kept on staying outside the overlap of the conventional financial framework, despite the extension of the wide system of the sorted out financial framework profound into country zones. Market and the administration both neglected to give credit access to poor people. The disappointment of institutional activities and shortcomings of the exploitative casual arrangement of credit have brought forth Microfinance organizations. As Microfinance is the provision of loans and other financial services to the poor it leads in the financial development of the poor. Better access to formal financial institutions could help in removing the poverty and inequality problem because it will reduce the dependency of underprivileged and lower income group people on informal sources of credit. Besides, formal credit availability through self help groups will also encourage small entrepreneurs and underprivileged poor people for their prospects of initiating small business and hence would help in improving their standard of living and hence in reducing income inequality. Having this backdrop, the present study attempts to study the role of microfinance programs in eradicating social exclusion.

Literature Review

There are parcel of studies conducted on circumstance and difficulties of microfinance establishment over the world, however just hardly any examinations have been done on the related subject. In this context, Morduch & Rutherford (2004) advocated that the microfinance development coordinate the accommodation and adaptability of the informal sector, while adding reliability and the promise of continuity. Jayasheela, Dinesha, & Hans (2008) studied the role of microfinance in the strengthening of individuals and arrangement of reasonable credit accessibility to the rural low pay populace. The examination reads the open doors accessible for the microfinance foundations with an expanding interest for credit in the provincial regions because of lacking proper wellsprings of credit. Moses (2011) studied that micro finance has emerged as a catalyst of rural development, especially in the overpopulated country like India. Sarumathi & Mohan

(2011) found that microfinance brought psychological and social empowerment than economic empowerment. Effect of microfinance is considerable in strengthening. Effect of microfinance is obvious in bringing certainty, mental fortitude, expertise advancement and strengthening. Pareek (2011) considered that the microcredit movement has proved that it is possible to deliver financial services to poor people living in rural areas at a large scale, free from any reliance on subsidies. Raj (2011) stated that microfinance foundations have been demonstrated a significant financial wing to consolidate the poor in the financial segment. Presently on the other angle like the difficulties looked by the microfinance foundations, Badrudduza (2011) found the positive results shown by MFIs in many countries but still there are a number of challenges before the microfinance industry. Das, Srinivasan, & Kodamarty (2011) found that the microfinance delivery involves macro and micro challenges. The large scale difficulties looked by MFIs incorporate the unavailability of the micro finance services to the provincial poor, the capital deficiency of the MFIs, the demand supply rift in arrangement of microcredit and micro savings and the absence of ladies direction in advertising, assessment and conveyance of microfinance. The smaller scale difficulties incorporate the powerlessness to decrease the high exchange cost engaged with conveying microfinance, the non-accessibility of narrative proof and guarantee among larger part of country poor, trouble in diminishing the reliance of the rural poor on money lenders and in conclusion the issue of reimbursement following where loaning did not depend on narrative proof.

Objectives of the Study

1. To analyse to what extent microfinance programs have succeeded towards ensuring equity in distribution of income or in reduction of poverty in the Indian states.
2. To identify the challenges faced by the SHG Bank linked MFIs towards poverty reduction in some of the regions of India.

Methodology of the Study

The research is based on the study of region wise secondary data of all the States of India. The secondary data of Number of Bank Offices and total Number of Self help groups have been collected from official website of Reserve Bank of India and NABARD for the five years spanning from 2010-11 to 2014-15. MS Excel and Statistical package E-views have been utilized to run correlation and panel data regression analysis.

Panel data regression model has been applied to study the impact of loan disbursement by bank linked SHG's on income inequality across Indian states. Data for per capita state domestic product (pcdsp) has been considered as proxy of income inequality.

This simple panel data regression model can be expressed as

$pcsdp_{it} = \alpha + \beta\ loan_{it} + e_{it}$

Where,

i = Number of cross sectional units (state) = 1, 2, 3……………….31

t = Number of years = 1, 2, 3, 4, 5

Hence we have altogether 155 observations (it =155)

e is the disturbance term that is assumed to be independent and identically distributed .For the purpose of hypothesis testing we assume e_{it}as normally distributed.

Choosing between FEM and REM: Hausman Test

In general REM is considered suitable when number of cross sectional units is larger than number of time series observations which is valid for our case. However, selection between fixed effect model and random effect model has been performed more rigorously by applying Hausman test.

Random Effects Model (REM)

As Hausman Test concluded REM as suitable model for our observations, hence results are drawn on the basis of REM.

Under REM the individual effect (α_i) is a random variable with the mean value α_1 then the intercept of the i^{th} cross sectional unit can be expressed as

$$\alpha i = \alpha 1 + ui$$

So REM is expressed as

$$pcsdp_{it} = (\alpha_1 + u_i) + \beta\ loan_{it} + e_{it}$$

$$= \alpha_1 + \beta\ loan_{it} + w_{it}$$

Where $w_{it} = u_i + e_{it}$ is the composite random error term that has two components.

(i) u_i :cross section or individual specific random component

(ii) e_{it} : combined time series or cross section random error component

Data Analysis

Table1: Correlation between Region wise No. of Bank Offices and Total No. of SHGs

Region	**Correlation Value**
Northern Region	0.57
North-Eastern Region	0.85
Eastern Region	0.80
Central Region	0.89
Western Region	0.92
Southern Region	0.31

Source: Status of Microfinance in India, NABARD, (2010-11 to 2014-15); Handbook of Statistics on Indian States, Reserve Bank of India, 2015-16

Table 1 provides correlation between region wise number of Bank Offices and Number of SHGs. The study has observed strong correlation between Number of Bank Offices and Number of SHGs in all the regions of India except Southern region. This result implies that states which are having more formal financial institutions are having more number of SHGs during the study period. Microfinance institutions expected to reach those areas where the formal banking system failed to reach and the poor people have to depend on the money-lenders in order to meet their financial requirements. However, many big

MFIs operate in those states where the banking network very strong. In the states like North Eastern region where bank branches are limited, the coverage of Microfinance through SHG Bank linkage programme is also limited. Hence, poorer states having less number of formal banking network have less access to microfinance through SHGs.

Table 2: State wise amount of Loan Disbursed

Sl No.	State	Total Amount of Loan Disbursed *(Rs)*
1	Andhra Pradesh	4449297.71
2	Tamilnadu	1461478.03
3	Karnataka	1307064.45
4	Telengana	549961.72
5	Kerala	504807.65
6	West Bengal	383162.49
7	Odisha	337291.97
8	Maharashtra	330079.79
9	Uttar Pradesh	228372.81
10	Bihar	169767.93
11	Rajasthan	107557.64
12	Assam	81762.48
13	Madhya Pradesh	79541.91
14	Gujarat	73235.86
15	Chhattisgarh	44449.84
16	Jharkhand	41822.93
17	Tripura	31692.06
18	Himachal Pradesh	25715.65
19	Haryana	24716.43
20	Uttarakhand	21931.88
21	Punjab	12755.22
22	Goa	9069.88
23	Jammu & Kashmir	3605.84
24	Chandigarh	3026.00
25	Nagaland	2537.15
26	Mizoram	2196.38
27	Meghalaya	1988.63
28	Manipur	1860.76
29	Delhi	1816.92
30	Sikkim	919.04
31	Arunachal Pradesh	903.68

Source: Computed

Table 2 presents performance of Indian states with regard to the disbursement of loan under SHG Bank linkage programme during the study period. It can observed from the table that Southern States like Andhra Pradesh, Tamil Nadu, Karnataka and Kerala have disbursed the maximum amount of loan through SHG Bank Linkage programme whereas North Eastern States are having the worst performance. The Northern region is having poor performance next to North Eastern region in terms of loan disbursement. West Bengal's performance is quiet good just next to Kerala.

Table 3: Results of Hausman test

Variable	Fixed	Random	Var (Diff.)	Prob.
LOAN	0.029438	0.021248	0.000387	0.6773

Source: Computed

Hausman presented in Table 3 where Chi-Sq. Statistic has been found statistically insignificant with p value of 0.677, confirms the acceptability of REM as a better regression model as compared to FEM. From the result of REM model, it has been observed that sign of coefficient of independent variable is positive (0.02). This implies that amount of loan disbursement by SHG's has positive impact on reduction of inequality across states. Hence bank linked SHG have positive role towards poverty elimination in India. However, it is not statistically significant at 5% level of significance.

Table 4: Result of Random Effect Regression Model

Dependent Variable: PCSDP

Variable	Coefficient	Std. Error	t-statistic	p-value
Constant	71385.48	6876.130	10.38164	0.0000
Loan	0.021248	0.024949	0.851662	0.3957

Source: Computed

Table 5: Cross Section Effects

Sl No.	State	Effect
1	Andhra Pradesh	-14812.38
2	Arunachal Pradesh	5910.540
3	Assam	-27692.52
4	Bihar	-39716.51
5	Chandigarh	-16024.25
6	Chhattisgarh	-16190.15
7	Delhi	104017.00
8	Goa	79083.24
9	Gujarat	859.1363
10	Haryana	42989.26
11	Himachal Pradesh	-6684.425
12	Jammu & Kashmir	-17645.28
13	Jharkhand	-26181.22
14	Karnataka	2460.347
15	Kerala	-3461.492

16	Madhya Pradesh	-23698.93
17	Maharashtra	29074.08
18	Manipur	-38152.13
19	Meghalaya	-13737.09
20	Mizoram	-19961.76
21	Nagaland	-755.4693
22	Odisha	-21238.46
23	Punjab	11623.65
24	Rajasthan	-10781.63
25	Sikkim	37149.47
26	Tamilnadu	21082.82
27	Telengana	10237.38
28	Tripura	-23627.17
29	Uttar Pradesh	-34481.90
30	Uttarakhand	20112.19
31	West Bengal	-9756.342

Source: Computed

Table 5 justifies the application of regression model with intercept since there is presence of cross section effects i.e. each state is having an individual intercept as shown in the table.

Challenges

Constraints in SHG Bank Linkage of poorer states in India:

1. Very high interest rates are charged by MFIs for their financial sustainability. As the poor, find it difficult to pay, MFIs failing to reduce poverty by serving the poor.
2. Client retention is an issue that creates a problem in growing the MFIs because people are not informed and educated about service and products provided by MFIs.
3. Large amount of loan default has discouraged the disbursement of loans in poor states in India.
4. Lack of literacy in poorer states especially in rural areas and language barriers make it difficult for MFIs employees to make the clients understand the policy related details, which creates an obstacle for them to reach the target population.
5. Geographical location is one the key reason for MFIs lagging behind in some of the far-flung areas because of inability to facilitate BPL population of the country due lack infrastructure in those areas.
6. High transaction cost, lack access to findings, ineffective loan collection methods, high probabilities of frauds are also some of the possible causes of failure of Microfinance programmes towards poverty alleviation in some states of India.

Constraints in SHG Bank linkage of North Eastern States in India:

1. Difficulty in linkage Self-help promoting institutes (SHPIs) still face a lot of difficulty in linking SHGs to banks. The bank staffs at the field level remains uncomfortable in dealing with SHGs. Due to this human resource misalignment, SHPIs face problems in opening bank account of SHGs and linking them to banks for credit. The problem is aggravated due to the low penetration of banks.
2. MFIs in Northeast face a lot of problems in raising funds. The region itself is considered high risk by the banks, the banking infrastructure is weak, and MFIs still do not have scales or systems to be attractive to banks. The level of underdevelopment is both a cause and a symptom of this problem.
3. Due to low population density, poor infrastructure, and the high diversity of local cultures, the cost of operations in Northeast is high. MFIs thus have difficulty breaking even, and are forced in some cases to pass on those costs in the form of high interest rates.
4. There has been a lack of a representative body for microfinance in Northeast to raise region-specific issues at the national level, to carry out policy advocacy and to mobilize the sector.
5. The low connectivity of the region in general and the physical isolation of some parts is a big constraint on outreach.
6. North-eastern region has many diverse traditional systems and even geographical conditions across different states. These make it difficult to replicate the successful initiatives of one state into another. Sometimes it is difficult even to replicate it within the state.

Suggestions

1. Since MFIs are largely regulated the state governments, a selective guideline is needed to manage to MFIs in India.
2. Ensure the nature of MFIs in a situation of exponential development. Because of the quick development of the SHG-Bank Linkage Program, the nature of MFIs has gone under pressure. This is reflected especially in pointers, for example, the poor upkeep of books and records and so forth.
3. Proper preparing for the customers ought to be sorted out in a proficient manner with the goal that they could know every single little thing about their obligation each little thing about their obligation.
4. Ensure the uniform appropriation of small scale financing in both rural and urban regions of every province of India.

Conclusion

From the study, it is concluded that that bank linked SHGs have prospered more in the states having more formal financial institutions. The reach of microfinance institutions are lagging behind in the states which are really needy, creating the regional imbalance.

However, loan disbursement by these microfinance institutions have played a positive role in poverty alleviation and enhancing the living standards of the poor. There are various state specific problems faced by SHG Bank linked MFIs towards reduction of poverty in poorer states of India, which has to be mitigated at the state level so that the MFIs can reach the really target and needy population.

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