RJSMS LECTURER NOTE ON RURAL CREDIT AND MICROFINANCE.

I. INTRODUCTION

Development of an efficient financial services system is key enabler of capabilities which affects how well individuals can manage life cycle needs and also affects the functioning of enterprises and their prospects of growth. More broadly, it affects the extent of entrepreneurship and of competition. India is underserved by financial services on every parameter. More than 40 percent of households avail no banking service at all. The ratio of total bank credit outstanding to GDP is only about 57 percent as against over 140 percent in East Asia and Pacific. Insurance premia account for less than 1 percent of GDP, which is only about a third of international average (Govt. of India, 12th Plan, Document, Planning Commission).

Census of India (2011 Census)

58.7 percent households availing formal banking service in India, out of this 54.44% in rural, 67.77% urban households availing banking services, in rural areas more than 45 percent households faraway or not available any banking services. More
than 41 percent households throughout the India, they are excluded from the formal banking services. Especially those states Bihar, Odisha, MadhyPradesh, WestBengal, Chattisgarh, more than 50 percent households excluded from the formal banking services, in the case of north-estran states comprise (ArunachalPradesh, Nagaland, Manipur, Mizoram, Tripura, Meghalaya, Assam) average 47.6% households availing banking services. The organized financial sector does not reach out to large segments of the population in India. In this situation microfinance has emerged as a powerful instrument for providing basic financial facilities to the rural poor, women, small and marginal farmers. Micro-finance is defined as a provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban areas so as to enable them to raise their income levels and improve their living standard. In underdeveloped regions fighting with higher presser of population severe poverty and socioeconomic disparities, rural economy plays a crucial role for providing livelihood facilities. Generally these economies are constrained with low basic socioeconomic infrastructure facilities like Transport, telecommunications, energy, water, health and educational facilities as well as organized financial facilities like commercial banks, co-operative banks.
ii. OBJECTIVES
To explore relationship between rural credit and microfinance
To analyse the alternative Sources of Rural credit
To explore outreach and impact of SBLC and MFI in India

III. METHODOLOGY
The present study explores the relationship between rural credit and microfinance in India. This is a source of alternative informal credit sources of rural India. The present study provides evidence of emergence of microfinance as alternative sources of rural credit over a period of time because it is a blend of formal and informal credit. This study is based on the secondary data provided by different sources like Mix Market, NABARD, RBI and different govt. India agencies like Ministry of finance, planning commission.

IV. NATURE AND PROBLEMS OF RURAL CREDIT
There are three aspects of analyzing the nature and problems of rural credit markets: a) It is important to highlight the features of existing
credit markets and their function in order to bring out the inadequacies in terms of performance. b) Secondly, it is crucial to identify the type of credit that is typically asked for by the rural population in order to understand whether the existing credit markets cover the needs and, more importantly, whether the new institutions of micro-finance help in bridging the gaps, if they exist, in catering to the diverse needs of the rural poor. c) There are severe problems of adverse selection (on part of Lenders) and Moral hazard (on part of borrowers) in rural credit markets that pose problems to formal institutions.

IV(I)

THE CHARACTERISTICS OF EXISTING CREDIT MARKETS

Rural credit markets can be analyzed with respect to the following factors: a) Nature of competition b) Informational asymmetry. c) Market segmentation. d) Dependency on informal institutions. e) The problems of Adverse selection and Moral hazard. These features of rural credit markets combine to determine,
The efficiency of the functioning of these markets, b)
The quantum of Credit disbursed.c)
The accessibility of the poorer sections to credit facilities.

A.

NATURE OF COMPETITION
As Debraj Ray observes had the rural credit market been a competitive one the intersection of the corresponding supply and demand curves would have determined the equilibrium rate of interest that would have been uniformly charged by every supplier of credit which reflects the consumers' willingness to pay

1. This equilibrium would determine the optimal volume of credit disbursed. However the preconditions for a competitive market namely, the requirements that there be a large number of suppliers and the demand be so large in relation to any single supplier that his contribution to or withdrawal from the total quantum of credit does not change the equilibrium rate of interest in any significant way, and secondly, the information flows between buyers sought to be nearly perfect, are not met due to several factors.

a. Credit essentially serves many different purposes and therefore is by nature a differentiated entity. Therefore any particular supplier of credit may not be in a position to cater to these different needs of population.
Rural credit market is far from perfectly competitive because the features like large number of sellers is not met and this makes rural lenders to charge discriminatory interest rates.

Unlike in perfect competition, every buyer is not free to enter the market since in the rural credit market because the lender prefers fixed clientele which makes it difficult for a borrower to enter the market of a money lender in, say, a different village. This feature of rural credit market is linked with other features like informational constraints, market segmentation etc.


B. INFORMATIONAL ASYMMETRY

One of the main problems of rural credit from the point of view of a lender is that there is a lack of information regarding the use to which a loan will be put. Secondly, there is lack of information regarding the repayment capacity. This feature has implications on the risks of lending money which in turn has an effect on the interest rate charged. The lack of information to which a particular loan is to be put can be overcome if there exists a mechanism to monitor the loan. However, in rural areas formal institutions such as banks find it costly to obtain such information. In other words, the transaction costs are high. This has, in combination with the government policy of not charging
high rates of interest, the effect of limiting the quantum of loan that is given. Usually this is not in keeping with the requirements of the borrower. However, for private money lenders, who face the same problems, but do not have any ceiling on the interest that they can charge, the Lenders Hypothesis shows that the rate of interest charged depends upon the probability of default: Let $i = \text{Lenders rate of interest}, P = \text{Probability of repayment of loan},$ and $r = \text{market rate of interest}.$ Then, $P(1 + i) L$ will be the expected return to the lender at the end of the loan period. Had the lender put the money in the bank as an alternative, he would have earned $(1 + r) L$ on this amount. Lending is profitable if $P(1 + i) L - (1 + r) L > 0.$ Under perfectly competitive conditions, $P(1 + i) L - (1 + r) L = 0$ then, $i = 1 + r / P$ Thus the larger is $P$ (which means that the rate of default is small) the lower would be the rate of interest charged. In sum therefore, it can be said that the formal institutions that lend to the rural sections are limited in the quantum of credit that they disburse, whereas the informal institutions such as the money lender charges a high rate of interest on whatever amount that he lends out. From both sides the borrower is affected adversely. B.
MARKET SEGMENTATION
Theoretically, if there is scope for consumers to be segregated, then a monopoly seller would be able to price discriminate and increase his profits relative to a situation wherein he charges a uniform price. Market segmentation in our context would refer to the inability of consumers who are charged a high price in one market to move to the market where the same good or service is being sold at a lower price. Although in the rural credit market there is an absence of a single monopoly element in money lending.