

## **Convergence of Micro-finance and GP level Community Enterprise Systems to protect interests of vulnerable farmers**

**Amar KJR Nayak**

**Professor of Strategy and NABARD Chair Professor**  
**Xavier Institute of Management, Xavier University Bhubaneswar**  
Email: [amar@ximb.ac.in](mailto:amar@ximb.ac.in)

### **Abstract**

This perspective paper discusses whether Microfinance in India achieved the twin objectives of (a) freeing the resource poor from being dependent on the local sahuakar; who not only lends credits but also provides multiple services at the door step of rural poor and (b) graduate from credit transactions to credit-saving-business transactions. The article argues that despite the various institutions of credit and micro finance, the poor seems to be locked up with local sahuakars and has rather become more vulnerable today. The institutional structure of SHG-Bank linkage, credit cooperatives and other microfinance structure have not been able to graduate from credit to business transactions. Further, the present credit institutional arrangement has not been successful in getting the poor to invest their small surplus in banks. This perspective paper explores how the Farmer Producer Organizations (FPOs) could resolve both these issues in India if the microfinance function were to be converged with optimally designed cluster based Community Enterprise Systems (CES) at Gram Panchayat level.

**Keywords:** Microfinance, SHG-Bank Linkage, Village Sahuakar, Farmer Producer Organization, Investment options of poor, GP level optimally designed CES

### **Introduction**

Non availability of credit to rural poor and very high cost of credit from the local money lenders and sahuakars led National Bank for Agriculture and Rural Development (NABARD) to conceive the micro credit system through the Self Help Groups (SHGs) in the nineties. It helped poor women and household to come out of the credit traps. Following the successful innovation of SHG by NABARD, the Government of India adopted the Swarnajayanti Gram Swarozgar Yojana (SGSY) that lead to widespread replication of the micro credit model in the last over 20 years. Subsequently, many more development agencies, micro finance institutions joined and made it a mass movement. By the end of year 2015, NABARD plans to link nearly 92 million households in India through nearly 7.2 million SHGs under the SHG Bank linkage programme ([www.nabard.org](http://www.nabard.org)).

However, in the recent years, several issues have emerged in the microfinance sector in India. Most strikingly, the loan outstanding of the SHGs has been increasing and there has been a decline in the total number of SHGs in the country (Nair & Tankha, 2013, CCRD-LBSNAA, XXX). With high interest arbitrage between industrially advanced countries and rural India, the foreign financial institutions also began to add to the huge growth of sector but the bubble burst within a few years.

Over the years, several innovations have been attempted to improve timely delivery, credit quantity, repayment capacity, bank saving and overall social impact of micro credit to the rural poor in India. In order to facilitate micro saving, the Banking Correspondence (BCs) were introduced; performance of which has been poor till date (Nair & Tankha, 2013). Similarly, technology enabled credit and saving though is a great attempt, it has changed the situation for the rural agricultural poor. The national drive to create new bank accounts of the poor has been successful; but the transactions through these accounts do not exhibit the success. Further, formation of smaller banks to serve the needs of the rural poor has been undertaken. How would these resolve the issues of access, timely delivery, transaction cost of credit service, saving in banks by the poor, etc.; is not clear. The long time experience of Cooperative Banks and Regional Rural Banks do not seem to have solved these problems.

Micro credit through SHG-Bank Linkage programme has surely broken the dominance of local money lenders and sahuakars in rural India. However, has this removed the dependence of rural poor on the local sahuakars or do the sahuakars continue to exploit the rural poor? In other words, have the government interventions disabled the competitive structure of the local sahuakars? Are some fundamental dynamics of credit and saving of rural poor not fully captured in the various innovations that have been attempted so far? Further, have we fully deciphered the micro saving or investment options of rural poor or has there been a mismatch in the micro saving products offered by banks and the needs of the rural poor? Let's look at (a) expenditure pattern and sources of credit at times of distress of the poor and small farmers, (b) competitive structure of microfinance at the village level and (c) preferred saving and investment options of the poor in rural agricultural settings to be able to make sense of the situation and consider better policy options for the future.

### Expenditure pattern and sources of credit under distress

Based on a three district survey (Nayak, *et al* 2015) of 2100 farmers in both irrigated and rainfed clusters, it has been observed that farmer families spend the most for food that is nearly 30%. The second most critical expense incurred by farmer families is on agriculture amounting to 28%. It is interesting to note that while farmer families spend 10 % more in agriculture than that of farmer families in rainfed clusters, farmer families in rainfed clusters spend nearly 10% more in food than families in irrigated clusters. Other consumption expenses include clothes & house maintenance, health and education of children. These together make about 35% of the total expenses incurred by farmer families across the irrigated and rainfed clusters. Please see table below for the details.

Farmer Family share of total expenses for different purposes in different agricultural settings								
Agricultural Setting		AGRICULTURE	FOOD	CLOTH & HOUSE	HEALTH	EDUCATION	ANIMAL HUSBANDRY	MARKETING
Irrigated cluster	Mean	32.8%	25.6%	13.8%	11.7%	7.1%	2.1%	6.8%
	N	1050	1050	1050	1050	1050	1050	1050
	S. D.	1.7E1	1.2E1	7.6E0	9.2E0	9.1E0	4.2E0	5.9E0
Rainfed Cluster	Mean	23.0%	34.1%	14.7%	11.8%	7.9%	1.3%	7.3%
	N	1036	1036	1036	1036	1036	1036	1036

	S. D.	1.6E1	1.6E1	8.8E0	1.0E1	9.9E0	3.6E0	7.7E0
Total	Mean	28.0%	29.8%	14.3%	11.8%	7.4%	1.7%	7.0%
	N	2086	2086	2086	2086	2086	2086	2086
	S. D.	1.7E1	1.5E1	8.2E0	9.8E0	9.5E0	3.9E0	6.9E0

**Source:** Nayak, Amar et al (2015). Draft Report, NABARD Survey on Ramification of Debt Waiver & Risk Mitigation to make Agriculture Sustainable

A number of studies on microfinance and SHG Bank linkage show a similar pattern of expenses incurred by the poor households in rural agricultural settings (Tripathy S.N. 2015, Nair G.K. 2015, Mani G. & Tandon S. 2015, Sangwan S.S. & Deep G. 2015). Most of these expenses, especially health expenses are critical and emergency in nature. Credit from the formal channels viz., cooperative bank, RRBs, commercial banks and microfinance institutions is usually for agricultural production purposes and credit for these critical requirements are usually unavailable through these formal channels. Further, the transaction cost of lending for formal institutions are much higher than the informal lending sources (Srinivasan N. 2015).

In the absence of credit for these critical requirements, the small farmers and the poor seek credit from the traditional informal credit lenders viz., local money lenders, traders and sahuks/shop keepers in rural agricultural settings. Relatives and friends are other sources of credit at times of emergency. In addition to internal lending among members, SHGs also serve as another source of informal lenders in rural settings.

Among the various sources of informal credit, it is observed that local sahuks seem to be main and dominant credit lender under critical emergency situations. The second important informal credit lending has been from relatives and friends. Though SHGs do not seem to be significant lenders in the irrigated clusters, it is fairly significant in the rainfed agricultural settings. The role of money lenders and traders in rural credit lending surprisingly is relatively much lower as compared to the local sahuks. Please see table below for interest rate and frequency of dependency of farmers on different informal sources of credit.

INFORMAL SOURCES OF CREDIT IN EMERGENCY SITUATIONS INTEREST RATE & FREQUENCIES AS REPORTED BY FARMERS IN DIFFERENT AGRICULTURAL SETTINGS						
AGRICULTURAL SETTINGS		SAHUKARS	RELATIVES & FRIENDS	SHGs	MONEY LENDERS	TRADERS
Irrigated Clusters	Mean	28.35	23.71	24.00	22.91	24.00
	N	31	21	2	22	1
	S.D.	15.9	3.5	.000	3.9	.
Rainfed Clusters	Mean	49.70	48.94	19.54	25.75	48.00
	N	138	51	56	4	5
	S.D.	14.4	16.7	8.0	13.7	16.9

Total	Mean	45.79	41.58	19.70	23.35	44.00
	N	169	72	58	26	6
	S.D.	16.9	18.3	7.9	6.1	18.1

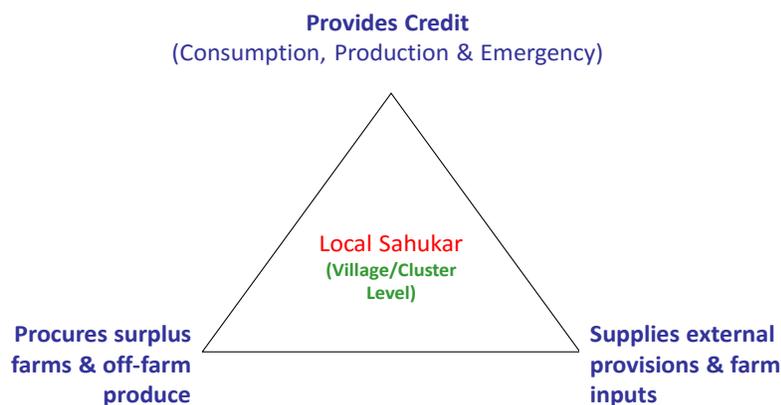
**Source:** Nayak, Amar et al (2015).Draft Report, NABARD Survey on Ramification of Debt Waiver & Risk Mitigation to make Agriculture Sustainable

Although the rate of interest charged by the local sahuakar is greater than other informal lenders of credit; what makes the local sahuakar the preferred choice for seeking credit by the poor and farmers under distress? While all these informal credit agencies are closer to the poor small farmers and are usually based in the community as compared to the formal credit lending agencies; the local sahuakar seems to have the edge. What are the differences in the type of services and quality of service offered by the various local shaukars, local traders, money lenders and SHGs? In the next section, we look at the institutional structure and product and service basket that probably gives the sahuakar the competitive edge over the other sources of credit.

**Competitive structure of microfinance at village-level**

Analyzing the competitors in a given settings helps us in understanding whether there is complete lack of service providers or there are monopolistic competition or a highly dynamic market for a product or service. Local sahuakars that have been rooted in the villages amongst the poor offer the stiffest competition to the top down structure of large banks and the SHG Bank Linkage programme in the country. A competitor analysis of this traditional rural credit system reveals that the power of control by these local traditional agents is indeed significant. Figure below provides the multi-pronged approach of a village based sahuakar in remote villages in the country.

Figure 1:  
**The Community based Institution of Sahukar**



Nayak, Amar KJR. 2012. Implementing Community Enterprise System for Sustainability of Rural Agricultural Communities: A Manual

While the formal banking system provides credit for production, there is little support for consumption and emergency credit. In the SHG Bank linkage programme; the other needs of credit are however met; as the credit here is not linked to a specific activity. The local institution of sahuakar had not only inbuilt these credit provisions but also provide services on a 24\*7 basis throughout the year.

In addition to providing credit for all purposes, the institution of the sahuakar provides other related services to the rural poor. It procures all surplus farm and off-farm products irrespective of the quality and quantity. It also supplies all possible external provisions and farm inputs at the door steps of the rural poor.

Being based in the community, the sahuakar supervises the production of the poor and ensures repayment through timely follow up of its clients. Even though, the poor is aware of the exploitation; she/he has little option not to be dependent on the local institution of the sahuakar who offers a convenient single window multiple services at the doorstep.

Has any of the extension activities of the government or any development agency matched the competitiveness of the local institution of sahuakars in India? But for a very few small cooperatives that are community based and have worked as a single window service provider for all needs of the poor; most of the interventions of the governments are top down and built on a specialized services viz., credit, agri-inputs, marketing, etc.

### **Vulnerability of the poor**

The state supported microcredit through the SHG-Bank Linkage programme since 1990s has come as a great relief to the poor; as it freed the poor from the high cost credit from the local sahuakars. However, in the context of deep rootedness of the institution of the sahuakar in rural India, how has the state supported credit intervention impact the relationship between the poor and the local sahuakar? How would the poor deal with her/his other service requirements viz., procurement of consumables, other services and sale of her/his surplus produce? In the absence of institutional options for these services, the poor is likely to rely on the local sahuakar for these services. Having partially lost his credit lending business, would the local sahuakar tend to seek greater rents from his clients, the poor for these services?

Even if the poor has reduced the cost of credit through the SHG-bank linkage, a part from the increased agricultural production is grabbed by the sahuakar who still continues to be a key player in procuring the agricultural produce from the poor. This has been possible due to lack of reach of the government promoted marketing outfits to rural poor and the inability of the rural poor to organize themselves for collective marketing of their produce. In the absence of alternative buyers, the local sahuakar takes his pound of flesh from the poor by negotiating lower procurement price for the produce or through improper weighing scales.

The local sahuakar has yet another window through which, he seeks his additional pound of flesh from the net income of the poor. Having reduced his credit lending portfolio, the local sahuakar has strengthened his retail services on consumables and emergency services like vehicles for personal transport, tractor for agriculture and mill for grain processing. With limited choice available for these services, the rural poor again go to the local sahuakar for these services; who in turn seeks his rent from the poor on these transactions. A study on the change in wealth of sahuakars as compared to poor of the respective village during the last two decades would clarify how the wealth created through various development interventions in agriculture and rural India have got distributed.

Empirical evidences from an on-going action research in 55 villages of two tribal GPs in Rayagada district during 2009-2015 showed that when a new institution or development agency offers a single or fewer services than those offered by the local sahuakar; it makes the poor more vulnerable than before. The poor were actually threatened for breaking away from the traditional business relationship with the sahuakar and were charged extra rent for the services that were sought from him.

### **Saving and investment choices of the poor**

Analyzing the investment choices and saving patterns of the poor indeed is quite revealing. Let me present here a conversation that I have had with women of an SHG group working as a sangha with Deccan Development Society in Zaheerabad district, Telangana state. When I asked the women of this group; *what would you do if you had some surplus income?* They said; *“we would buy more food for ourselves”*. Then I asked them; *what would you do if you still had some more to save?* They said; *“we would buy food for our children and grandchildren”*. Then I went on to ask them; *what would you do if you still had more to save?* They said; *“we would repair our houses”*. Curious about their responses, I further asked; *what would you do if you were still left with some money to save?* They said; *“we would buy some chicken and small animals like goats and pigs; and if we still had more we would buy a pair or two of cattle”*. Then, I took the courage to ask them; *what would you do if you still had more to invest?* They said; *“we would buy some gold”*. Unable to find bank as one of their option for saving, I took another chance to ask them; *what would you do, if you were still left with some more to save?* They said; *“we would buy some land”*. Finally frustrated, I asked them bluntly; *when would you save your surplus money in a bank?* To my amazement and surprise, they answered; *“when we do not have any use of the money; we put it in a bank”*.

Indeed the choices of the poor to invest or save their surplus money are many and varied as is shown in Figure 2 below.

**Figure 2: Sources of Differential Savings & Investment for the poor**



Source: Nayak 2014, Lecture for IAS probationers at LBSNAA

The saving or investment options of the poor actually offer much higher rates of return than the interest on savings in any bank. The choices of investment as mentioned by the women also provides them greater flexibility for encashing easily, better liquidity, and minimize transaction costs for exchange; if the investments made are required for family consumption purposes. The procedural trouble of bank deposit and withdrawal is also avoided by the women folk through these investments. Indeed, I realized that the poor women folk were focused on investment and not on mere saving that I was biased with.

There have been lot of efforts to simplify the procedures and enhance access of banks to the poor through bank mitras, banking correspondents and providing ATMs. However, the rate of return on saving and the flexibility offered by the banks is no match to the traditional investment options of the rural agricultural poor in the country. Clearly, there is a mismatch in the micro investment need of the poor and the banking structure for saving. Accordingly, the SHG-Bank linkage programme largely appears to have remained to be a unidirectional credit supply and repayment system.

### **Way Forward to Microfinance**

With the above context where, (a) the microfinance system or any credit institution of the government is not competitive to the institution of local sahukar in terms of the multiple services it offers, and (b) the disconnect between the saving products in the banking system and the investment choices of the poor; how do we go forward? Can we design an optimal cluster based community enterprise system (producer organization) consisting of SHGs at a Gram Panchayat/cluster level that is to be managed by grass-root level managers consisting of 2-3 trained professionals and few local youth. The team of grass-root level managers can undertake all the multiple services of providing credit, saving options, procure all surplus produce of the resource poor, and supply most of the consumables and services required by the people in the community. It may even take up issues of sanitation, drinking water, preventive health care, primary education of children and basic village infrastructure at the optimal cluster level.

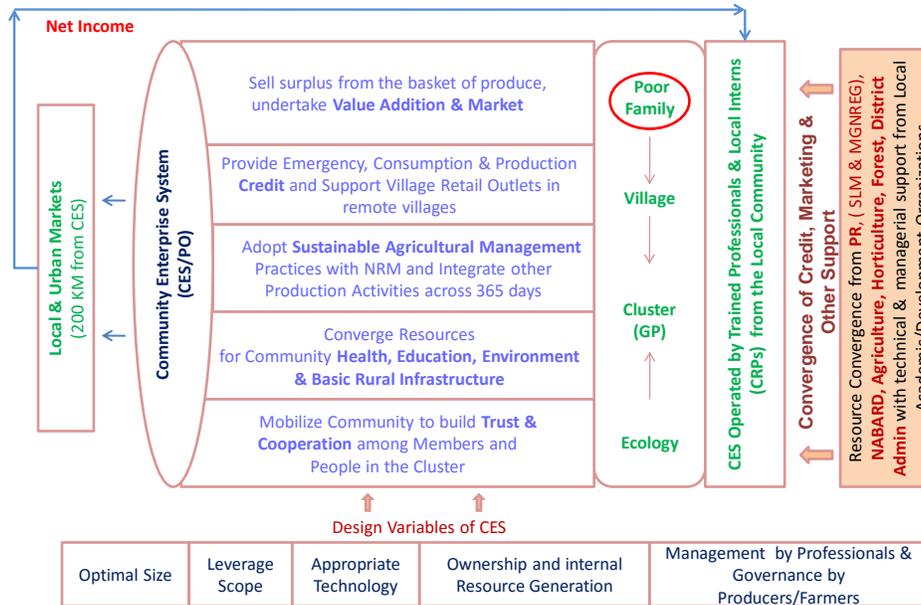
In communities; where SHGs have been saturated and SHGs have been in operation for a few years, we may consider the community based producer organization model at the Gram Panchayat (GP) level that can facilitate micro investment plan for individual poor families/household in the traditional way and at the same time find greater value for their produce through better marketing system (Nayak, 2013). The speed of credit delivery, timeliness and flexibility of credit needs of the poor can also be achieved at a much lower transaction cost if the credit is routed through the GP level producer organization.

The design of the producer organization that can overcome the present limitations of the microfinance and other development interventions; however needs to be carefully designed simultaneously on size of membership and its geographic spread, multiple scope of activities or services it needs to engage in, appropriate technology of agricultural production and processing, a mix of trained professionals and local youth for managing the operation of the producer organization and the gradual building of ownership of the poor in their respective producer organizations. Based on the action research on recreating sustainable community system, the optimal size that has been arrived at is approximately 1000 resource poor producer families<sup>1</sup> in a cluster of about 1500-2000 hectares of geography which is equivalent to a Gram Panchayat in rural agricultural settings.

In addition to the above internal design of the proposed community enterprise system (CES) or farmer producer organization (FPO), we also need to optimize the market distance to increase the net income of the resource poor. The optimal market distance seem to be within 200 Km where the net incomes for the small producers is maximum. For the community enterprise system (producer organization) to deliver multiple services, the various resources of the government need to be converged with the

producer organization. The proposed design of the sustainable community enterprise system (CES)/FPOs is shown in Figure 3 below.

**Figure 3: Organizational Design & Institutional Relationship For Optimally Designed GP Level CES/ FPO s**



**Source:** Nayak, Amar KJR. 2013. Implementing Community Enterprise System for Sustainability of Rural Agricultural Communities: A Manual

The figure above shows the multiple functions that the producer organizations need to take up; though in a phased manner. It shall not only offer credit and saving linkages at the door step but also engage marketing and value addition of different surplus produce of the poor. It can also undertake retail services required by the poor. Further, the GP based producer organization can take up the health, sanitation, drinking water, preventive health care, primary education and rural infrastructure, agricultural extension services for the people at the GP level. Such a community based, owned and managed producer organization working as a single window service provider to the resource poor can drastically remove the present asymmetric disadvantages of the poor in the rural agricultural ecosystems and has the potential to create a stable and healthy community.

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**End-notes**

<sup>1</sup> The design factor for this number is 4; that is even if a fourth of this number share strong solidarity and work together, the group would be financially viable. Since the community participation is usually low under the present market system, the optimal membership size has been kept at this level.

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