An Essay on Micro-Finance: An Effective Tool of Poverty Reduction in India

Vivekananda Journal of Research
July - December 2023, Vol. 13, Issue 2, 97-108
ISSN 2319-8702(Print)
ISSN 2456-7574(Online)
Peer Reviewed Refereed Journal

https://vips.edu/journal/

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ABSTRACT

Access to financial services is essential for the poor and vulnerable section of society. Employment possibilities will be generated which will reduce poverty. However, due to excessive risk and inadequate collateral given, traditional financial institutions are limited in their ability to serve the unbanked section of society. Farmers, landless labourers, rural artisans, and women who must pay a moneylender an outrageously high rate of interest is among these unbanked people. Microfinance institutions were created and supported by the government and NGOs to get around these restrictions. Self Help Groups (SHGs) are such a type of community-based microfinance organization. This commentary examines how the microfinance model (SHG) can eradicate poverty in rural India.

Keywords: *Micro-Finance Model, Poverty Eradication Model, Self Help Groups*

INTRODUCTION

India still lives in its villages. According to the 2011 census, 833.1 million people still reside in rural India. The percentage of unbanked people in rural India is higher. Farmers, artisans working in rural areas, landless labourers, members of underprivileged social classes, and women make up this unbanked population. Access to financial services is essential for this poor and vulnerable section of society. Poverty might occur from a lack of financial services since there aren't enough employment opportunities. Even today, it is observed that 88 percent of the extremely poor reside in rural India (Chintakula, B. 2020).

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Financial services can be utilized to create employment opportunities, which will reduce poverty. However, formal financial institutions cannot serve this section of society due to high risk and insufficient collateral offered. Hence, a grassroots level institutional ecosystem is necessary. This institutional eco-system is needed to deliver their credit requirement.

This Institutional Eco System will not only provide a socio-economic opportunity but also an opportunity for employment generation. It is being observed by **Thakur (2016)** that the best way to alleviate poverty in rural areas is to generate employment opportunities by undertaking entrepreneurial activities. This will lead to the achievement of sustainable growth. The analysis shows that there is a declining trend, the number of SHGs linked to the BLP in 2011-12 is 79.60 lakhs as compared to 74.30 lakhs in 2013-14. The study further extended to the performance NPA percentage of loans. Surprisingly, it was found that there was a marginal decline in NPA from 7.08 per cent in 2013to 6.83 percent in 2014. This indicates the effective working of SHGs.

Another study by **Maity and Sarania (2017**) indicates the effectiveness of an SHG program on the employment, income, and poverty of rural households. The study was carried out in the Bodoland area of Assam. The data was collected using a primary survey from districts namely, Bodoland, Baksa, and Udalguri districts. The survey was conducted between May 2013 and October 2013. A total of 330 respondents from both the controlled and non-controlled groups were selected through the multistage purposive sampling method. The results of the study showed that the employment days of the SHG participants increased significantly from 108 to 119 days per year. To estimate the poverty levels of the members, the study used the Foster, Greer, and Thorbecke (FGT)weighted poverty index. Gini Coefficient and Atkinson measures indicated that the inequality level greatlydeclined by a range of 0.07 and 0.05 percentage points among the SHG members compared to the non-SHG members. The analysis based on the Index of financial inclusion has shown that nearly 63 percent of non-SHGmembers were excluded from formal financial sources in the study area and surprisingly none of the SHG participants was excluded from it. The proportion of households receiving high financial inclusion (61-99) was 26.7 percent whereas for non-SHG members it was only 4 percent. The Chi-square indicated that there was a significant association between SHG membership and achieving financial inclusion. The t-test results showeda significant positive impact on the level of financial inclusion of SHG members over non-SHG members.

This commentary's first section indicates an outline of the subject and a literature review indicating the impact of SHG at the grassroots level. The next section lists numerous microfinance model experiments that have taken place throughout history. It also sheds some light on how different model evolutions have progressed. The third section indicates the objectives of this work. Self Help Groups (SHGs) and other models that were introduced in India are highlighted in the fourth section of the paper. The fifth section with the help of the graphical presentation structure of SHGs, shows the development of the microfinance model; from micro savings to microentrepreneurs.

HISTORY OF VARIOUS MICRO FINANCE EXPERIMENTS:

History of various microfinance experiments is divided into two sub sections. The pan India scenario has been presented separately to understand the evolvement and process of micro-finance at grass root level.

Global Level Scenario

The history of microfinance or micro-credit as an effective tool for poverty reduction dates to the early civilizations of India and China. However, owing to the lack of adequate documentation, details of the ancient Indian financial system are not available in minutiae. In the 1700s, the 'Irish Loan Fund' was a famous micro-credit organization by Johnathan Swift who extended the loan to the needy without any collateral (*Hollis and Sweetman, 1996*) and by 1840 it extends throughout Ireland. It was also observed that in the middle of the 1800s' theorist "Lysander Spooner" recognized the need for micro-credit for those who are associated with agriculture. Although during these periods many credit institutions and banks, cooperatives started operating all over Europe (Hollis and Sweetman, 1996). These institutions aimed to support the un-bankable population. The economic disaster due to the Irish famine has an adverse bearing on these institutions. Credit unions in Europe and North America were also greater initiatives in the 1870s to reduce the dependency on informal sources of finance (Prinz, 2004). It was unable to achieve a reduction of the financial burden of the rural poor and mobilized the saving and investment to a large extent.

With regional variations, financial services and credit groups were operating such as chit funds in India, Cheetu in Sri Lanka, Susus in Ghana, Tandas in Mexico, Arisan in Indonesia, and Tonities in West Africa. Chit Funds in India were good initiatives, with fixed time duration and preplanned value as agreed by members, these credit groups serve both the functions to save and to provide credit (*Economic Times, 3/2/2020*).

India Level Scenario

An economist from Bangladesh developed a model (*1978*) with the help of the

Grameen Bank. This model encourages the poor and women to take up small activities and reduce their dependency on informal sources of finance.

The employment-driven approach to mitigate poverty was initiated in the form of the Integrated Rural Development Program (IRDP, *1978*). It offered financial assistance and productive assets to the rural poor. However, it supported the deprivation in the rural region due to a lack of marketing facilities and nonsaleable goods. The demand from services and the industrial sector was not enough to create an opportunity for earning. Additionally, entrepreneurial development skills were not focused on. Hence, this model was not much of a help (*Kakar D. and Maheshwari M.M, 1970*). The next comes Swarna Jayanti Gram Swaraj Yojana (SGSY) by modifying IRDP in 1999.

SGSY targets to reduce multi-dimensional poverty by developing skills and providing employment opportunities. In 2011, further modification was taken place by replacing all previous schemes into one umbral scheme known as National Rural Livelihood Mission (*NRLM, 2011*). SHGs' presently part of this umbrella scheme of NRLM.

SHG in India

SHGs have started formatting with various schemes and missions. They were formed as micro-saving institutions by various agencies. The pilot role was played by National Bank for Agriculture and Rural Development (NABARD) and Mysore Resettlement and Development Agency (MYRADA, in Mysore) in 1992. By 1994, 500 SHGs were linked with banks (*NABARD, 2018-19*). SHG bank linkages program, supported by NABARD has achieved success due to awareness at the grass root level. Nagyya and Rao(*2016)* observed that 7.90 million saving-linked SHGs are working in India. It is essential to note that women are empowered economically through this model. Commercial banks, regional rural banks and cooperatives are positively providing support in the form of loans to these groups. The success of the credit limit entirely depends on how the group is operating and its return policies. The features of members are essential in determining the functioning of SHGs and the duration of their functioning (*Ahmad et., AI, 2020).*

2005 was designated as the "year of microcredit" by the United Nations to promote these initiatives by India and other nations. As micro-finance is recognized as an effective tool to reduce poverty. Market forces, the government, and non-profit organisations have all supported the fast expansion of microfinance institutions (Bansal and Bansal, 2012). These institutions operate at the grass-root level, which is plagued by acute poverty and a lack of job possibilities. The reasons for these poor conditions are lack of awareness, inadequate resources, and skills to utilize the available resources, high risk and vulnerability, obsolete technology, insufficient market scope and most importantly lack of access to formal sources of finance (Bansal and Bansal, 2012). Nurturing such microfinance institutions may help in facilitating financial opportunities to un-privileged rural masses. Also, improve the socio-economic status of rural India by alleviating poverty. SHGs are one such institutional arrangement that is supporting rural India.

OBJECTIVES

This commentary paper tries to identify:

a) Structure and Evolution of Micro Finance

b) The functioning of Self-Help Group(SHGs) in India.

WHAT ARE SHGS?

The institutional ecosystem that operates in rural India includes self-help groups. It is an informal system where the female (members) comes together and forms a group. With a pre-determined amount, the group started saving. Additionally, financing (within the group) and recovery followed. The members agree upon the interest rate and time frame in a mutually beneficial manner. It helps them to develop financial skills and understand the process and requirements of formal sources of income such as a bank. Once they apply for a bank loan, it also supports members to cultivate their skills for income generation activities. SHGs are saving induce micro-finance model to eradicate poverty.

OTHER MODELS

NABARD has developed the Joint Liability Groups (JLG) model to fulfil the credit needs of small and marginal farmers. They form a homogeneous group with similar socio-economic backgrounds. The loan from the bank can be availed by either an individual or a group. However, the group is responsible for repayment. Sarma and Mehta (2014), examined the difference between JLG and SHG and traced out the advantages and disadvantages of both models.

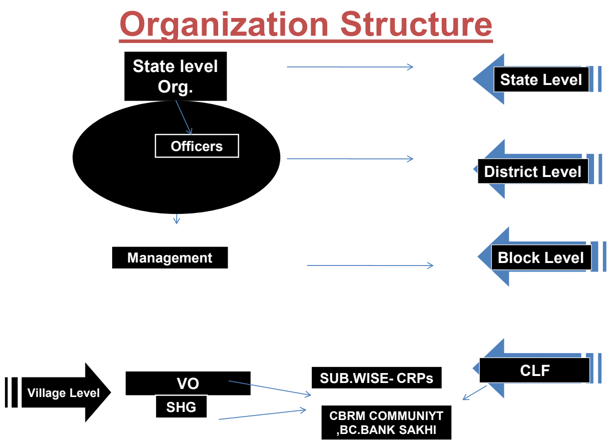
JLG is a relatively new model inspired by the Grameen model of Bangladesh. JLG does not require any physical collateral to get the loan, members get a loan on a mutual guarantee basis and members would charge a penalty in case of repayment delay. It would also affect the loan sanction for next time. In terms of lending, JLG members are provided facilities on a cycle basis. In the first cycle, a very small amount of loan will be sanctioned and the successful repayment of this loan will give a chance of availing a high amount of loan in the next cycle.

On the other hand, the SHG is an autonomous financial institution. It has great flexibility in saving the amount and size of the loan and repayment, etc. However, the SHGs are eligible to get a loan after 6 months of their formation.The major proportion of loan amount is spent for daily consumption purposes because these requirements arenot fulfilled by formal financial institutions.

SHG model is more democratic and decentralized due to its internal control of members. It sometimes leads to a threat to the longevity of the group. Saving is the basic principle of this model and often leads to an excessive financial burden on the members. While in case of JLG aims to access loans, it is more credit-oriented and does not have any compulsion to generate internal loans.

The main objectives of the SHG are to look at the social developmental issues and help in poverty alleviation.These groups are formed with the base of credit accessibility, while JLGs are formed with the assumption that rural areas have a huge demand for credit, therefore MFIs act as financial intermediaries. The study also compared the cost-effectiveness of both models in which the SHGs are less cost-oriented because they areself-reliant whereas the cost is very high in the case of JLGs due to the involvement of MFI employees in these groups' operations. However, this study lacks any empirical support.

Structure of Grass Root level Eco-System- SHGs:



The grassroots level Institutional Eco-system known as Self Help Groups has a strong foundation and structure.

First Layer: SHG -Village Level

Self-help groups, the first layer of the SHG structure work at the village level. It is mandatory to have a minimum of five and a maximum of twenty members for a group. SHGs get seed funds in the form of a Revolving Fund(RF), depending on the categories of members... Hence, opportunities are generated at the grassroots level for the rural poor.

The basic outline for each SHG is the same i.e. follow Panch Sutra (i.e. regular meetings, regular saving, internal lending, regular repayment, and bookkeeping). The internal structure of SHGs is decided by the group. In many cases, it has a leader, secretary, and an accountant. The accountant can be internal or external, if external they get paid a pre-decided amount. The officer bearers-leader are compulsorily on a rotation basis.

The members of each group meet on a fixed date and place as determined mutually. They are expected to maintain the documents, account details and details of each member. Account details include internal and external borrowing, bank loan and repayment, interest charges in internal lending etc.

The regular meeting encourages members to make regular deposits. This cultivates saving habits among members. However, unlike the savings account of the banks, there is no interest to be earned. A member can borrow from the group by paying a pre-determined interest rate. These activities create awareness and habit among members to save-lend-repay. It also develops and creates basic financial management skills. The SHGs are required to operate in this fashion for six to nine months before they interlink with the bank and district federation.

Second Layer: CLF and VO

Each SHG of a village is represented by a village-level organization (VO). Each SHG is required to contribute to the VO corpus.

SHGs of a few (two to five) villages are represented by the Cluster Level Federation (CLF). SHGs are required to contribute to the CLF corpus. The structure is like SHGs, with three office bearers -leader, secretary, and account. The VO and CIF also carry similar activities as SHG groups i.e., financial management, group activities, and interaction with banks. However, they also interact with other agencies ---financial and non-financial.

The benefit of these institutions is financial for grassroots-level institutions.

SHGs gets Community Investment Funds (CIF) from these groups as assisting amount on a rotating basis. Community Resources Person (CRP) plays an important role in each layer i.e. SHGs, CIF and VO. Further, an essential task has been carried out by CRP. It supports SHGs in administration and management if required. Depending on the requirements and skills they have been allocated multiple roles.

They also mobilize the household to form the SHGs. In some cases, they are responsible for providing basic training to SHG members on how to format the group, what are the advantages of such a micro-credit group, how to avail the bank loan, the importance of micro-saving and micro-credit, record management etc. However, the majority of internal CRPs are a part of one or other SHG groups. External CRP if invited from outside the state, essentially plays the role of a trainer.

Third Layer: Block Level

Social mobilizing and development, institutional development, livelihood activities, and basic training are conducted by the block-level officer. They guide and assist the SHGs. Each block is identified as an intensive or non-intensive block.

Intensive blocks are provided financial and structural support for three to five years in the form of a community investment fund (a loan with subsidy) to be self-reliant and self-sustainable. Non-intensive blocks are provided with limited management and financial support (NRLM*, 2021)*.

Fourth Layer: District Level

The district-level management units have a representative from VO and CLF. However, one district-level manager is the supervisor of the committee.

Fifth Layer: State Level

The state-level manager units consist of various office bearers. An expert from various segments such as inclusion, livelihoods, management of a programme etc. would support implementing NRLM in the state (*NRLM, 2021*).

This decentralization structure led to the devolution of power and finance. At this grass-root level, SHG women are independent to utilise the fund at their convenience There is special fund allocation for this scheme which through devolution reaches poor households.

SHG members in the form of revolving funds and community investment funds received various financial support. The group can also avail of a bank loan. Hence, they can shift households/groups from micro-credit to micro-enterprise units. This Institutional Eco-System supports households in creating employment opportunities and alleviating poverty.

As observed above, each layer is involved with others, it not only reduces transaction costs but also leads to transparency. This fiver layer structure of present SHG also supports grassroots-level women to work and empower. These empower women can be entrepreneurs to uplift their standard of living and transform rural regions with the help of more exclusively focus programs of SHGs. They can be written as extensions of SHGs.

Extension of SHGs

The saving-inter-lending and recovery are the basic steps SHGs, however, the group united shall take a step ahead by engaging in productive activities. It is an asset for a village they can work unitedly for the welfare of their household and the village. The SHG is expected to work as entrepreneur units - for both agriculture and small industry and services sectors. With the support from local and national government SHGs are offered: MKSP (Mahila Kisan Sashaktikaran Pariyojana), SVEP (Start-Up Village Entrepreneurship Programme), and NRETP (National Rural Economic Transformation Project). SHGs are aiming to move from the micro-savings unit to the micro-entrepreneur unit with the help of different models as presented.

MKSP (Mahila Kisan Sashaktikaran Pariyojana)

'Mahila Kisan Sashaktikaran Pariyojana' (MKSP) was introduced for food security and to engage more women in agriculture. It is important to note that Women are already working as agricultural labour in villages (*32%, (http://mksp.gov.in*). There exists a vast wage difference between men and women (*Kundu and Das, 2019*). They do not have adequate information related to agriculture due to workload. MKSP is providing proper training, required information, pest management, and creating awareness for the same.

SVEP (Start-Up Village Entrepreneurship Programme)

To eradicate poverty by providing employment opportunities to the rural poor is the idea of the Start-up Village Entrepreneurship Programme (*SEVP- 2016*). The model analysed the local demand and available resources to provide operational training and guidance. The training will be provided, on how to manage the business, and financial funding. Rural artisans, traders, and entrepreneurs have greater scope as they invest in individuals and groups. IRDP failed to embrace the services and manufacturing sector, however, the limitation has been removed with the SVEP model.

NRETP (National Rural Economic Transformation Project)

With funding of $250 million, the National Rural Economic Transformation Project was introduced. Since 2005, both the UN and WB have encouraged various activities to eradicate multidimensional poverty by providing various self-employment opportunities. However, supportive infrastructure and services are required for efficient utilization of investment in the rural poor. (*World Bank, 2020*). The project is motivated to facilitate enterprise development programs for rural poor women and youth in the agricultural sector.

CONCLUSION

The outline of this Eco-System indicates the process of evolution of SHGs. The process that are now also involved in a wider range of activities, such as skills development, income generation, and community development. This evolution is being driven by a number of factors, including the increasing availability of government and donor support, the growing awareness of the potential of SHGs to address a wider range of social and economic issues, and the entrepreneurial spirit of SHG members themselves.

Despite the progress that has been made, many SHGs still face challenges in accessing finance from formal financial institutions. This is due to a number of factors, including the lack of collateral, the small size of loans required, and the high cost of processing loans. Further, many SHG members lack the skills and knowledge necessary to manage their groups effectively, start and run businesses, and access government and other support programs. Therefore, there is a need to provide SHG members with high-quality capacity building programs. In some cases, they may not produce good quality of product which survive the market. In other cases, SHG members produce high-quality goods and services, but they often struggle to find markets for their products. Therefore, there is a need to help SHGs develop market linkages and build their marketing and branding capacity.

This Eco-system facilitate n poverty reduction plan. SHGs also play an important role in community development by promoting social cohesion, empowering women, and advocating for the rights of the poor. SHG proves to be a successful model in raising the standard of living of the rural poor by creating local-level employment and employability through extension models.

Note: This work is funded by Ministry of Education, vide ICSSR through IMPRESS/ P3276/17/2018-19/ICSSR

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