MICRO FINANCE-THE EMERGING SOLUTION TO RURAL POVERTY

Adesh Sharma\textsuperscript{a,ψ} and Sugandha Singh\textsuperscript{b}

\textsuperscript{a}Athena Infraprojects (Power sector), India
\textsuperscript{b}University of Delhi, India

Abstract
Despite making spectacular progress in various fields, India still faces poverty, unemployment and socio-economic inequality. New economic forces are bringing with them new opportunities for development and for contributing to nation building. It is however important to ensure that our growth is inclusive and we do not leave anyone behind, and the benefits of development reach everyone, particularly the rural masses who have not been effectively touched by the efforts of six decades of freedom. The policies and programmes formulated to augment economic growth should also contribute towards improving the lives of poor and vulnerable. More than 70 per cent of our people live in villages and 80 per cent of our poor live in rural areas. Poverty, hunger and health care represents some of the major challenges before rural India. The unenviable Plight of the landless laborers and small and marginalized farmers can be attributed to factors such as natural calamities, crop failures, lack of adequate supplementary income and low level of education and exploitation by money lenders. Acute poverty, indebtedness and illiteracy are among the factors that have combined to compel many farmers to take their own lives. The scarcity of credit and lack of saving mobilization has been recognized as the basic problem of poverty. The ineffectiveness of the vast network of banks and other financial institutions, especially established to meet the needs of the rural sector and the poor, led to the emergence of Micro Finance. It is in this backdrop that the present paper attempts to develop a comprehensive model of Micro Finance to overcome the issues of rural distress through a linkage between Self Help Groups (SHG), NGOs and banking system.

Keywords: Self-help groups; NGOs; Rural poverty; Women empowerment

JEL Clasification Codes: I31; I32.

1. Introduction
Microfinance has the potential to become an important component of successful and sustainable poverty alleviation program. Microfinance can be defined as any activity that includes the provision of financial services such as credits, savings, and insurance to low income individuals which fall just above the nationally defined poverty line, and poor individuals which fall below the poverty line, with the goal of creating social value. The creation of social value includes poverty alleviation and the broader the impact of the improving livelihood opportunities through the provision of capital for micro enterprise, and insurance and savings for risk mitigation and consumption smoothing.

There are basically three types of risks which poor confront:
- Structural Risks – which are often long term or permanent changes in the National and International economy which impact the ability of the poor households to sustain the income.
- Crisis Risks – which are sudden, unexpected shocks to household that disrupt its ability to generate income or force it to allocate a certain portion to an area not included in its established economic portfolio, for e.g. illness, fire/accident, theft, robbery.
- Life-Cycle Risks – in which there is certain degree of predictability but entails expenditure

ψ Corresponding author. Adesh Sharma. Economic Advisor, Athena Infraprojects (Power sector), India. Corresponding author Email: dradesh_sharma@yahoo.com
This segment of the population requires specific poverty alleviation intervention which ensures income distribution and at the same time purchasing power redistribution since they do not have enough purchasing power to participate in the market economy.

In India, microfinance is being pursued through SHG- Bank linkage model and Microfinance Institutes model. The subject of providing credit to support people in rural areas and to the poor in particular has been explored extensively from time to time in India. The Indian credit system has emerged as a product of evolution as well as intervention. The major objectives of policy innovations have been

• To institutionalize credit
• To enlarge its coverage
• To ensure provision of timely and adequate credit at reasonable rates of interest to a large segment of population. In providing credit to the rural sector, a multi-agency approach has been adopted so as to take advantage of the strengths of different institutional forms.

As on March 2005, 1.54 million SHG’s comprising 22 million poor households were accessing credits through 35,000 branches of 560 commercial and cooperative banks under the SHG- bank linkage program. The cumulative disbursement of loans by the SHGs has been Rs5, 674 crore. The evolution of SHGs can be observed at three levels:

• At the 1st level households use microfinance to meet ‘survival’ requirements where small savings and loans serve as a buffer in the event of an emergency or to smoothen consumption or even service previous debt to give itself more liquidity during lean times.
• At the 2nd level, ‘subsistence’ needs are met through microfinance, where a household, begins to utilize microfinance to diversify its basket of income generating activities, or to meet working capital requirements in traditional activities.
• At the 3rd level as households reach a stage where they can assume a higher degree of risk, microfinance would be used to invest in setting up an enterprise or facilitating entry into employment in one way or the other in order that the household becomes ‘sustainable’.

Microfinance can play a vital role in changing the lives of the poor. There may not be a quantum jump in income but it is still possible to ensure a reasonable rise in the income of the poor. According to C. Rangarajan in process of widening the scope of microfinance, the following points are vital to be considered:

• As micro credit expands, as it must, banks need to introduce appropriate organizational changes in the various branches in order to play a pro-active role in bringing more and more SHGs under the bank linkage programme. NABARD in consultation with RBI must also play a part in initiating this change.
• Self Help Groups must transform themselves from pure thrift institutions into groups promoting micro enterprises. In that situation, the success will depend upon the choice of products to be produced and the markets to be served and the creation of an appropriate marketing mechanism.
• The legal form of Self Help Groups needs clarification. This assumes importance if the SHGs are to get federated into much larger organizations which can command greater credibility and, therefore greater ability to borrow.
• The legal form of Micro Finance Institutions also needs clarification.

2. Evolution of microfinance

Micro Finance in India had evolved over a period of time. Although there is no universally accepted definition, the task force on supportive policy and regulatory frame work on Microfinance has defined it as under:

“Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards.”

While microfinance is one of the key tools of poverty reduction, several challenges are faced while implementing microfinance initiatives such as, developing interventions which not only give access to services but also increase client incomes and decrease vulnerability; ensuring that targeting women
contributes to gender equality; deepening poverty reach to the poorest and most disadvantaged groups; resolving potential tensions between these development aims and financial sustainability; design and delivery of appropriate products and services required by the poor; ensuring a balanced geographical spread of the access to micro-finance; and encouraging commercial banks to downscale to provide microfinance.

Due to the above complexities a new mechanism to dispense credit to the poor has evolved over a period of time. This new format essentially takes care of thrift, savings; need based small loans, non rigidity about the loan usage, flexible repayments depending on the families’ cash flow rather than project based cash flow etc. collateral securities have been done away with and in its place social collateral is being used to ensure proper recovery.

3. Vicious circle of poverty
Economic Development can be defined as “the process of improving the quality of all human lives”, which incorporates three equally important aspects: raising incomes and consumption; fostering self esteem through institutions that promote human dignity and respect; and increasing people’s freedoms. This criterion has a distinct application to this particular development process. Robinson, a great economist, contends that “the first thing that many poor families do when their incomes rise is improve their nutrition, and send their children to school”. This is fundamental to economic development, but also, “because financial services help the poor expand their economic activities and increase their incomes and assets, their self-confidence grows simultaneously”. And finally “large-scale sustainable microfinance helps create an enabling environment for the growth of political participation and democracy”. Thus the economics of microfinance make it a compelling anti-poverty strategy.

While there are several structural dimensions to rural poverty, it is generally accepted due to the lack of capital or lack of surplus. The rural poverty in India is characteristically self-perpetuating caught in the “vicious cycle of low economic status”.

Thus, rural people and especially the farmers have always been in the need of credit. And, indebtedness has become the core problem of Indian farmers. Money lenders known variously as mahajans, sahukars, shahu, lent loan for both productive and unproductive purposes at exorbitantly high rate of interest. But still the uncertain nature of monsoon and famine condition made the peasants to be highly dependent on money lenders. Thus, Sir Richard Temple says’ “with all his faults, the moneylender is a useful man, and often gives credit when it is most needed.”

**Approach to extend microfinance**
Since poor are bankable but can’t afford any collateral, method of reckoning ‘Social collateral’ had been considered ‘Self Help Group’ approach was adopted. A Self-Help Group (SHG) is a registered or an unregistered group of micro entrepreneurs having homogeneous social and economic background

voluntarily, coming together to save small amounts regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis. The group members use collective wisdom and peer pressure to ensure proper end-use of credit and timely repayment thereof. In fact, peer pressure has been recognized as an effective substitute for collaterals.

Savings and Thrift, Internal lending, discussing problems and Planning are the major functions that a SHG performs. All SHG members regularly save a small amount. The amount may be small, but savings have to be regular and continuous habit with all the members. “Savings first-Credit later” should be the motto of every SHG member. It is through savings that SHG members take a step towards self-dependence. They learn financial discipline through savings and internal lending, making them better off while using bank loans. These savings amount should further be used for giving loans to its members. The purpose, amounts, rate of interest, schedule of repayment etc. are to be decided by the group itself. Also proper accounts should be maintained by the SHG. In every meeting, the SHG should be encouraged to discuss and try to find solutions to the problems faced by the members of the group. Together with solving members’ problems, the SHG should also prepare plans for the future so that each member can collectively work for the achievement of the same. It should plan to get financial support from Government, Bank and NGO for its sustainability.

Financing through SHG helps economically poor individual to gain strength by being a part of a group. Besides, it also reduces transaction costs for both lenders and borrowers. While lenders have to handle only a single SHG account instead of a large number of small-sized individual accounts, borrowers as part of a SHG cut down expenses on travel for completing paper work and on the loss of workdays in canvassing for loans.

A SHG is a group of about 10 to 20 people, usually women, from a similar class and region, who come together to form savings and credit organizations. They pooled financial resources to make small interest bearing loans to their members. This process creates an ethic that focuses on savings first. The setting of terms and conditions and accounting of the loan are done in the group by designated members.

SHGs have also federated into larger organizations. The following flowchart shows a graphic illustration of a SHG Federation.

![Figure 2: SHG Federation flowchart](image-url)
Typically, about 15 to 50 SHGs make up a Cluster/Village Organization with either one or two representatives from each SHG. Depending on geography, several clusters or Village organizations (VO) come together to form an apex body or an SHG Federation. SHGs Federations have presented some key benefits to SHGs as a result of their greater scale. In addition to the benefits of SHG Federation, there are some drawbacks which need to be considered. It has a poor capacity for self-governance, average to low quality managers and systems and process are poorly defined. Further, there is significant financial cost to organizing and registering a SHG Federation which has been estimated to be about Rs. 7,000 per SHG member. To bridge these internal constraints requires savvy external assistance and there are few good quality NGOs to provide this assistance to a burgeoning number of SHG Federation.

A Non-Governmental Organization (NGO) is a voluntary organization established to undertake social intermediation like organizing SHGs of micro entrepreneurs and entrusting them to banks for credit linkage or financial intermediation like borrowing bulk funds from banks for on-lending to SHGs.

4. Models Of Microfinance

There are certain criteria set up by NABARD which the SHGs need to fulfill for their linkages with the banks:
- The group should be in active existence for at least a period of six months.
- Have successfully undertaken savings and credit operation from its own resources.
- Democratic working wherein all members have a say.
- There should be genuine need to help each other and work together among the members.
- Members preferably have a homogeneous background.

There are two ways in which SHGs are linked to banks –
(i) Direct linkage and (ii) Indirect linkage Model.

(i) In the first case, Banks identifies the group and deals with SHGs directly for both mobilizing the savings and for making available the credit facilities.

**Figure 3: Direct linkage and indirect linkage model**

**Direct Linkage Model**

Direct linkage model can be classified as:
(a) Modified Direct Linkage Model-I

Under this the group identifies the activity and members to whom loan is given and the group itself is morally responsible for repayment.

(b) Modified Direct Linkage Model-II
In this model NGOs helps in group stabilization. It does not act as the financial intermediary but helps to promote sustainable linkage between SHG and bank even after their withdrawal.

**Indirect Linkage Model**

In this case, the funds flow through NGOs i.e. NGO is financial intermediary. However it distorts the role of NGOs and creates dependency of groups on NGOs for assessing credit.

**Modified Indirect Model**

Here the NGOs are directly helping the SHG members in the income generating activity, etc.

**Grameen Model**
Here the financial assistance i.e. loans for productive purposes is provided by the MFIs/NGOs directly to the members of small groups (i.e. consisting of 5-7 members) directly on the strength of group assurance. It is often coupled with an obligation to save by the group members.

**Figure 4: Role of group corpus**

The funds from the government enrich the group corpus by way of subsidy; the NGOs and Banks supply credit as per the need of the group. The group is then involved in inter-loaning activities for consumption and production processes. By pursuing productive economic activities it enhances its income, repays the loan amount to the bank and spends it on basic health, education, etc. so as to drive one out of the poverty trap.

**5. Status of the sector**

According to McKinsey India survey, April 2006, rural India has the potential to become a US $500 billion market by the year 2020. Currently, roughly 75 per cent of the micro credit supply is via the Self Help Group - Bank linkage route largely financed by NABARD and the rest comes from MFIs, increasingly backed by commercial banks.

Micro finance through Self Help Groups has reached a respectable position and it is being acknowledged as the biggest microfinance intervention in the world. About 29.30 lacs Self Help Groups are reported to be linked to bank credit till March 2007, as it is shown in the table below.
SHG statistics of NABARD

The table shows that there has been a fast growth in recent years of SHGs that are linked with banks i.e. Commercial banks, RRBs and Cooperative banks for meeting credit requirements and other financial needs of SHG members.

Table 1: No. of SHGs linked to banks in India, 1992-19993 to 2006-2007

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of SHGs</th>
<th>Bank Loan (Rs. Lakh)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
<td>255</td>
<td>29</td>
</tr>
<tr>
<td>1993-94</td>
<td>620</td>
<td>65</td>
</tr>
<tr>
<td>1994-95</td>
<td>2122</td>
<td>245</td>
</tr>
<tr>
<td>1995-96</td>
<td>4757</td>
<td>606</td>
</tr>
<tr>
<td>1996-97</td>
<td>8598</td>
<td>1184</td>
</tr>
<tr>
<td>1997-98</td>
<td>14317</td>
<td>2376</td>
</tr>
<tr>
<td>1998-99</td>
<td>32995</td>
<td>5707</td>
</tr>
<tr>
<td>1999-2000</td>
<td>114775</td>
<td>19298</td>
</tr>
<tr>
<td>2000-01</td>
<td>263825</td>
<td>48090</td>
</tr>
<tr>
<td>2001-02</td>
<td>461478</td>
<td>102630</td>
</tr>
<tr>
<td>2002-03</td>
<td>717360</td>
<td>204870</td>
</tr>
<tr>
<td>2003-04</td>
<td>1079091</td>
<td>390420</td>
</tr>
<tr>
<td>2004-05</td>
<td>1618476</td>
<td>689800</td>
</tr>
<tr>
<td>2005-06</td>
<td>2238525</td>
<td>1139700</td>
</tr>
<tr>
<td>2006-07</td>
<td>2924973</td>
<td>1804070</td>
</tr>
</tbody>
</table>

6. Way forward

Recently released Report of Committee on Financial Inclusion 2008, is very clear about the importance of microfinance and the initiatives to be adopted by various lending agencies to device appropriate products to cater to the needs of the population still kept out of banking ambit. It is quoted that “access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. This has to become an integral part of our efforts to promote inclusive growth. In fact, providing access to finance is a form of empowerment of the vulnerable groups. Financial Inclusion denotes delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low income groups. The various financial services include credit, savings, insurance and payments and remittance facilities. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty”.

On the basis of the above mentioned facts and analysis it can be concluded that microfinance which was unknown two decades back has become an important tool for reaching the unreached, underprivileged and inaccessible population. Though the rules of the game are same for the entire country, microfinance as a concept has attained popularity in few states (i.e. Andhra Pradesh, Orissa, West Bengal, Maharashtra and Gujarat). The need of the hour is to convince everyone especially the political and bureaucratic circles which is the only way out to take this movement forward.

References


Thakur, B. K. (n.a) *Micro-finance and its relevance after reforms: A special focus on rural credit in India*. S.K.M. University: Dumka