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Microfinance: Contemporary Effects on Poverty Alleviation in Rural Bengal

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Abstract

This paper makes an effort to assess the benefits of microfinance through self-help groups, state-led and NGO-sponsored microcredit schemes on poverty alleviation in rural West Bengal. The performance parameters used in the investigation involve wage rate, consumption expenditures, income bearing and asset holding capacity, employment and skill generation, and financial viability of these projects. The research is empirical, based on mainly secondary data collected from various government agencies and independent researchers. The study reports that microcredit institutions have had a marginally positive impact on earnings and asset retention, by opening up new livelihood opportunities and smoothening their consumption. However, its performance in terms of job creation and financial feasibility remains dismal. Therefore, a multipronged approach that includes social safety nets is the need of the hour to address the regional mismatch between the concentration of poverty and that of access to credit. Microfinance programs and poverty alleviation schemes are complementary, rather than being absolute substitutes for each other.

Keywords: *microcredit, microfinance, poverty, Bengal, rural*

1.0 Introduction

This paper is an investigation into the claim that microcredit is an effective and financially viable alternative to the existing models of addressing rural poverty through the provision of credit, where microfinance is the spectrum of financial services aimed towards low-income groups which have a low principal value. Microcredit is one such form of microfinance, where small loans are provided at low-interest rates. Microcredit has been receiving a significant amount of attention across the world, especially in developing countries such as India. The distribution of land in India remains skewed and the lack of any accumulated wealth from previous generations has resulted in an inadequate resource base for production. Despite major structural changes in the credit institutions and other forms of rural financial services in the post-independence period, exploitation of rural masses in the credit market is a persistent feature of rural life in India (Swaminathan, 2007). Microcredit can play a significant

role in bettering these conditions by supporting productive rural enterprises, stabilizing consumption patterns and generating wage employment.

Rural credit institutes in India date back to the nationalization of commercial banks in 1969. The adoption of directed lending programs and the development of credit institutions such as Regional Rural Banks (RRBs hereafter) and Integrated Rural development program (IRDP) were used as credit-based poverty alleviation tools, often implemented by commercial banks that provided loans at concessional rates to the marginalized sections of the society (Chavan and Ramkumar, 2002). A limited supply of formal credit and the inability of the state to effectively implement targeted policy has been major drawbacks of India's credit institution. Political and economic segmentation of local markets and institutional leakages have resulted in the isolation of rural markets from the conventional banking structure and credit provisions to priority sectors such as agriculture have been fairly limited. The need for credit in the countryside varies from production purposes (capable of generating income) to consumption purposes (food, housing, clothing, etc.), and in times of exigencies and crises. It is important to take cognizance of multiple facets of poverty while trying to analyze the impact of microcredit on poverty reduction.

2.0 A Review of Existing Literature

Multidimensional poverty encompasses the various deprivations experienced by the poor people in their lives—poor health, lack of education, inadequate standards of living, disempowerment, poor quality of work, the threat of violence, and living in areas that are environmentally hazardous among others. However, in the literature on microcredit, poverty mainly refers to income poverty. Microcredit schemes, as part of social development banking, can be defined as the “elevation of the entitlements of the previously disadvantaged groups to formal credit even if this may entail a weakening of the conventional banking practices” (Copestake et al, 1984). Microcredit for consumption purposes reduces the livelihood enhancing effects of these loans, but from the point of view of poverty reduction, such consumption loans are not entirely 'unproductive' as these loans act as a security mechanism against dependence on high-interest informal loans.

There could be a sequential change from consumption loans to loans for income-generating purposes. Microcredit is expected to reduce vulnerability and poverty via asset creation, opening up new livelihood opportunities, skill formation, and collective bargaining through groups (Chakraborty, 2020). Indian banking policy has attempted to involve public banking networks in the provision of microcredit to the poor through self-help groups (SHG hereafter). SHGs work on the principle of group lending and peer monitoring and are fundamentally different from the conventional credit institutions in terms of the size of the loans, the need for collateral, and its linkages with the banking structure.

Several performance indicators were looked at while evaluating the impact of microcredit schemes on poverty alleviation such as targeting of the beneficiaries, income or asset holding capacity, employment and skill generation, and financial viability of such programs (Chavan and Ramkumar, 2002).

In India, microcredit institutions have generally performed better than state-led institutions for credit provision. The performance of the Integrated Rural Development Program (IRDP hereafter) has been strikingly poor. It was found that no preliminary surveys of the families below the poverty line had been conducted and the attendance at the weekly SHG meetings in village assemblies was dismal. On average, the percentage of ineligible beneficiaries in IRDP was about 15-26 % (NABARD, 1994). However, microcredit schemes also suffer from Type 1 (exclusion) and Type 2 (inclusion) errors (Mishra, 2007).

One of the huge positives of these microcredit programs is the increase in the participation of women in terms of decision-making autonomy regarding social, economic, and familial decisions on intra-household relations across social groups. Improved self-esteem, increased household decision-making, and financial autonomy along with an expanding business and social network add a lot of economic and non-economic value in their lives. The SHG offers the canvas to conduct social intermediation, which would, in turn, provide women with the opportunity to acquire the ability and entitlement to control their own lives, set their agenda, gain skills, solve problems and develop autonomy. Based on the studies reviewed, microcredit

institutions have led to a positive but marginal increase in the earnings of the beneficiaries. This resulted in smoothening of consumption and income streams and beneficiaries had a higher propensity to retain their assets.

Scholars have taken two extreme positions on the issue of generating self-employment and wage employment. Dandekar (1986), Rath (1985), and Dreze (1990) have argued that generation of wage employment through large-scale public work is the most effective strategy for the alleviation of poverty, while Dantwala (1986) has supported the strategy of generating self-employment opportunities towards achieving this aim. Nevertheless, microcredit does not offer a solution to the perpetual state of technological backwardness in the countryside. It is not an instrument for mobilizing large-scale funds for technological change, which are necessary for overcoming the historical imperfections and fragmentations of the rural credit market.

The issue of financial feasibility has been a matter of wide criticism of microcredit schemes in recent years because of mounting administrative costs and high dependence on subsidies. The questions of sustainability, outreach, and sale of microfinance and the ways and means of targeting the poorest of the poor continue to be important issues facing the practitioners of microfinance (Mishra, 2007). The failure of financial institutions and the banking system to deal with poor borrowers imaginatively and sustainably and the inaccessibility of these institutions to the poor are stated to be major disadvantages of the existing system (Swaminathan, 2007).

The program's emphasis on repayment and fiscal discipline does not allow it to grow and scale its operations, without incurring higher transaction and administrative costs. Microcredit and other financial services help economically active people in improving household and enterprise management, increase productivity, smooth income flows and consumption costs, and diversify their micro-business (Robinson, 2001). Though very small, the spillover effects of microcredit programs on the local economy have also been observed across India (Khandker, 2001). Local-level planning and judicious allocation of resources in sync with the local governments is critical in ensuring smooth delivery of microcredit mechanisms with no

leakages. For instance, IRDP performance in West Bengal is a lot better since these are implemented via the panchayat channels.

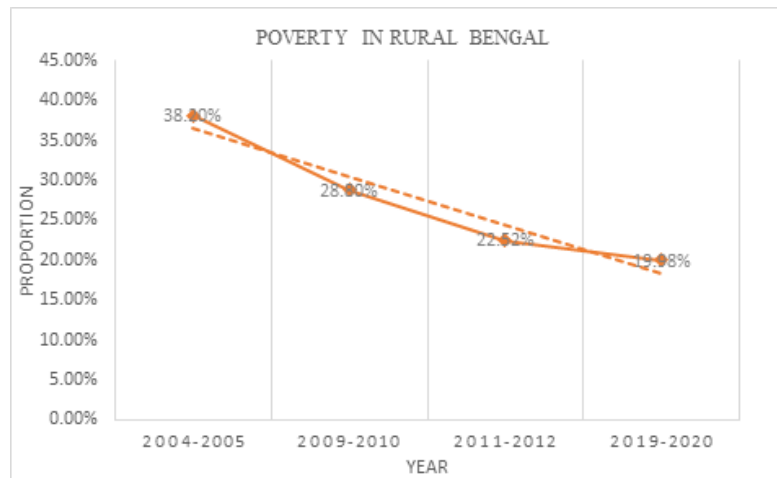
3.0 Poverty in Rural Bengal

3.1 The Structure and Patterns of Poverty

Poverty has been a deep-rooted issue in rural Bengal since the 18th century. Historically, Bengali farmers were subjected to inhuman exploitation by colonial occupiers. This exploitation materialised in the form of high taxes, unfair commercial exploitation and a lack of focus on human development through the betterment of health services and access to education. An example of such exploitation would be the infamous Ryoti and Zamindari systems introduced by the British wherein farmers were forced into contracts to grow indigo which would be sold at a fraction of the market price. This was coupled with frequent natural calamities which led to famines and epidemics which led to the death of hundreds of thousands and economic degradation of millions. Thus, the seeds of poverty were sown centuries before the country became independent.

Post-independence, Bengal saw a declining trend in poverty from the 1970's (Chakraborty, 2017). Till the late 70s, Bengal had witnessed an unstable political base, however from 1977 stabilization returned as the Left Front came into power. Till then Bengal's economy was characterized by high rates of rural poverty and stagnation in agriculture. However, agrarian reforms introduced in the 1970s and the reorganization of the local systems of governance led to Bengal witnessing a sustained period of agricultural growth and reduction in rural poverty till 1994. (Sengupta & Gazdar, 1997)

Graph 1: Poverty In Rural Bengal



Source: Data Published by the NITI AAYOG and the Reserve Bank of India

However, the most notable change in poverty has been witnessed in the past decade. Since 2004 the poverty rate has faced a steady decline, reaching an all-time low of 19.8% in 2019 (NITI AAYOG, 2019). It is also pertinent to note that the rural poverty line for West Bengal happens to be lower than the national average, implying that the consumption of goods, rurally, is also lower. Bengal's poverty rate falls just below the national poverty rate which was 21.92% in 2019.

Structurally, poverty is mostly concentrated among agricultural labourers and small farmers. Since the 1990's the rate of growth of agricultural labour has overtaken the rate of growth of the net sown area and land-augmenting agricultural technology (Ghosh, 1998). Therefore, the rate of absorption of agricultural labour remains low. Responding to this change, agricultural labourers have shifted to non-agricultural labour. A startling majority of the rural workforce consists of non-agricultural labour, which is much higher than the national average. The work of such labourers is mostly seasonal and subject to mercurial demand, leading them to go in and out of poverty.

Small farmers face an entirely different issue. As their landholdings are small, they are unable to wholly commercialize their crop, nor are they able to afford the technology to improve their land. Therefore, they are unable to accumulate any savings, and often have to depend on

debts given out by local moneylenders to survive. Naturally, these debts have high-interest rates. Secondly, these farmers are subject to natural calamities such as typhoons which destroy their crops, hence their source of livelihood. Farmers with larger landholdings can afford insurance on their crops, hence they have some protection.

Table 1: Occupation wise Distribution of Rural Workers in West Bengal

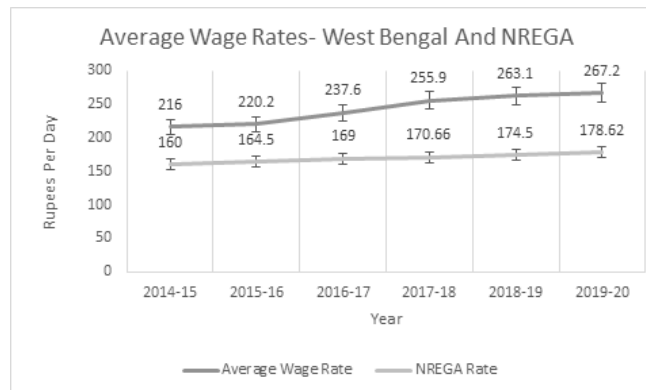
<i>Occupation</i>	<i>Total (000)</i>	<i>%</i>
<i>Agriculturist</i>	<i>5117</i>	<i>14.72</i>
<i>Agricultural Labourer</i>	<i>10189</i>	<i>29.31</i>
<i>Non-Agricultural Labourer</i>	<i>19451</i>	<i>55.96</i>

Source: Census 2011

3.2 Poverty and Wage Rate

Wage rate is defined as the daily earnings of a labourer. In the rural economy, there exists a deep correlation between the average wage rate and the poverty rate. An increase in wages can lead to a decrease in poverty and vice-versa. Optimally, the wage rate must far exceed the current year's poverty line. Wage rates have increased steadily over the past five years in Bengal and as of the latest estimates the average labourer earns ₹267.2 daily while the poverty line (MRF Method) remains at ₹31.1 per day (RBI, 2020). Noting the relationship between wage rate and poverty, we can conclude that this consistent increase played a major role in reducing poverty.

Figure 2: Wage Rate Comparison of Bengal's Markets and NREGA



Source: RBI Reports and MNREGA Database

It has been argued that the National Rural Employment Guarantee Act (NREGA) has caused an increase in the wage rates of various states, as NREGA has been widely successful in providing wage employment to millions across the country. However, in West Bengal, this isn't necessarily the case. The average rates offered by NREGA are much lesser than the average going rates of the state; NREGA also increases at a comparatively lower rate than the average wage rate. We conclude that NREGA alone is not sufficient to explain the increase. Other possible sources for such an increase may be an increase in money supply (via microcredit, or otherwise) or various local state-sponsored schemes.

3.3 Consumption Expenditure

Although there has been a significant increase in Bengal's rural consumption expenditure (more than doubling within a span of 9 years), Bengal has remained far below the national average. In the latest consumption expenditure survey conducted by the NSSO (2011), Bengal's average rural consumption expenditure was ₹1291 while the national average remained at ₹1521. We conclude that although the growth is indicative of a decrease in poverty, it has remained insufficient.

4.0 An Analysis of Performance Indicators

As previously discussed, poverty is a multidimensional phenomenon. It is not constrained to a poverty line defined by the State, but it also includes factors such as consumption expenditure, capital formation, access to education, household income, indebtedness etc. In this light, the consequences of microcredits on the rural economy must be judged on this spectrum of social conditions.

4.1 Consumption Expenditure and Indebtedness

Consumption expenditure is an indicator of the level of access households have to various goods and services in the economy. Wealthier households tend to have a higher consumption expenditure in general. Consumption expenditure is measured using surveys that ask target groups about their consumption of a basket of selected goods, from which conclusions are drawn about the average level of consumption expenditure. Naturally, a higher level of consumption implies a higher level of income. Hence, consumption expenditure becomes an important aspect of measuring poverty.

In rural West Bengal, microcredit plays the role of reducing informal debt and funding consumption. Of a sample of 1341 households, it was found that 72% of the credit supplied to the households had been used for financing consumption (Guha, 2005). However, in this case, consumption includes lumpy consumption or unexpected expenditures such as spending on illness, crop protection, financing education etc. Further, 9.5% of individuals used microfinance loans to fund the repayment of other loans, which had a higher rate of interest. As loans given out by microfinance institutions have a very low rate of interest and usually don't require any collateral, households have used such instruments to pay back informal loans with higher rates of interest.

Therefore, we conclude that microcredit serves as a buffer that poor households use to finance their expenditure. However, it is important to note the strategy of using microcredit to reduce rural indebtedness is not water-tight. Considering the volatility of rural markets, especially in

Bengal where they are subjected to vacillations caused by both man and nature, it can lead to the failure of families to pay back the original principal. Noting the increase in consumption expenditure in Bengal till 2011, it can be concluded that microcredits did not serve to bolster this increase but to act as a preserver of the finances of rural households, hence protecting them from poverty.

Table 2: Purposes of Loans

Purpose	% of Households Surveyed
Consumption	72%
Loan Repayment	9.5%
Production	18.5%

Source: Survey Conducted by Samapti Guha, Tata Institute of Social Sciences

4.2 Wage Rates and Income

Credit in the rural economy has a feeble yet noticeable effect on the going wage rate. There exists a body of literature that suggests that an increase in the money supply in the rural economy will lead to an increase in the going wage rate (Alam, 2014). Further, when households invest their credit into labour-intensive production, it raises the wage rate as new labour joins the workforce. As discussed previously, Bengal has witnessed a rapid rise in the wages of daily labourers. Even though West Bengal has one of the highest microfinance penetration rates in the nation (Champatiray et al, 2011), it is still only 20%. Secondly, we see that the use of microfinance for production remains quite low. Therefore, we conclude that in Bengal's case there exists a very weak relationship between the two.

Income, on the other hand, has a stronger correlation with an increase in the availability of microcredits. It has been observed through microfinance initiatives such as the Swarna Jayanti Gram Swarozgar Yojana, which promote self-employment and capital formation via the supply of affordable credit, that there has been growth in household incomes (Bhattacharya et al, 2008).

It is relevant to note that the use of credit in the region for capital formation and self-employment via other streams remains low (see Table Y). Hence, there exists a huge potential to promote products through microcredits in the region.

4.3 Bandhan Bank: A Case Study

Bandhan Bank is a West Bengal based financial institution that specializes in delivering microcredit to rural and under-represented households of the nation. It was started in Kolkata in 2001, where it specifically provided microloans to underprivileged sections of society. It was given an NBFC (Non-Banking Financial Corporation) status in 2006. It has expanded its operations since 2015 and now offers credit across the nation, with a specific focus on the eastern and northeastern regions.

What makes Bandhan Bank unique in the Indian banking environment is the sheer scale on which it operates as a microfinance institution. With over 3,500 branches spread across India, it is the largest microfinance company in India. It is also the first-ever microfinance institution in India that managed to earn consistent profits from its operations while focussing on the needs of rural women.

The accomplishments of Bandhan in rural Bengal demonstrates the poverty alleviating capabilities of an organized microcredit delivery system. Bandhan primarily lends to self-help groups for the purpose of initializing production or for capital formation. By 2015, Bandhan had advanced ₹9,119 crores worth of loans with very few cases of non-performing assets (0.13%), most of which was used for promoting micro-enterprises (Bose, 2015). Further, studies conducted by Soumili Bose (2015) indicate that “microfinance schemes of Bandhan have helped to alleviate poverty at a larger scale”. This is supplemented by the findings of Vishal Singh (2016), who concluded that Bandhan’s lending has led to a greater awareness of microfinance and a reduction in poverty. Through its enterprise-oriented lending which focuses on SHGs and underrepresented sections of society, Bandhan bank has emerged as a fairly successful microcredit institution.

Bandhan also helps to alleviate poverty by financing emergency consumption needs of rural households through its micro-health loans. These loans are specifically given out to clients who require emergency funds for sudden health issues. These loans are usually availed by households to prevent their savings from drying up and to stop them from falling into the grip of poverty. This is an example of how microcredit can bolster the consumption of services of households and act as a buffer to stop financially weak families from moving into poverty.

In conclusion, Bandhan represents what the possible positive effects of an organized microcredit delivery system could be and parallels the productive behaviour of microcredit all across the state.

5.0 Sustainability, Outreach and Scalability of Microcredit Schemes:

5.1 NGO- led Microcredit vs State intervention

Sustainability and replication of successful models of microcredit schemes have come under the scanner due to the presence of complex intermediary linkages and the need for constant injection of cash. There is a lot of scepticism about the expansion of these schemes and institutionalizing itself into a macro-level, sustainable scheme for poverty. The relatively smaller scale of operation of Grameen Bank has been its greatest advantage in evading the problems encountered in a large-scale credit provision institution. A comparison of the magnitude of operations of Grameen Bank and state-led credit institutions reveals the limited scale of operation of the former. In 1992, Grameen Bank had just 1.05 million borrowers. In the case of RRBs, the number of borrowers was 12 million in 1992 (Mosley and Hulme 1998). When Grameen Bank tried to expand its base in terms of the number of beneficiaries and disbursement of credit, the cost of scaling the operation as well as the coverage of population would pale in comparison to state-led poverty interventions.

5.2 Subsidy Dependence

Most of the rural credit programmes are subsidised. In the case of state-led programmes, the subsidy is borne by the government while in the case of NGO-led institutions, it is mainly

borne by domestic and international private donors. The Subsidy Dependence Index (SDI), developed by Yaron (1992) represents the percentage increase required in the lending rate such that the dependence on subsidies can be completely eliminated for a given institution. High dependence on subsidies does not allow credit institutions to expand their beneficiary base.

6.0 Financial Viability and Transaction Costs

6.1 Administrative Costs

Transaction costs include the cost of information collection, screening of borrowers and projects, monitoring and supervision, coordination, and the enforcement of contracts and collection of dues (Swaminathan, 2007). NGOs and SHGs cannot match the economies of scale of a comprehensive system of banking. From 1988-92, the cost of administration of the Grameen Bank constituted about 12.3 % of the bank's total portfolio. State-led microcredit initiatives such as Regional Rural Banks recorded the lowest possible cost of administration, amounting to about 8% of the bank's total portfolio. Evidence suggests that the cost of administration increases manifold when there is any attempt to scale up the operations of microcredit initiatives.

Table: 2

Year	Profits (million taka)	Financial Margin	Salary Cost as % of Total Cost	Break-even Rate of Interest	Average On- lending Rate of Interest	Subsidy as % of Loans Outstanding	Dependency on Foreign Funds (foreign funds as % of total funds)	Savings and Deposits as % of Loans Outstanding
1989	2.26 (93.46)	9.33	40.83	17.64	12.90	21.12	90.76	29.52
1990	10.22 (352.21)	8.77	42.32	20.34	12.90	21.57	93.57	33.32
1991	11.92 (16.63)	9.20	49.73	22.79	16.50	21.12	94.64	29.50
1992	(-5.65) (-147.40)	9.75	50.02	16.50	16.74	16.80	99.93	31.25
1993	9.56 (269.20)	9.48	44.06	14.85	15.96	11.90	58.12	42.44
1994	21.74 (127.40)	8.43	29.43	16.30	16.51	3.72	3.73	26.13

Note: Figures in parentheses represent growth rates from preceding year. Source: Khandker, Khalily, and Khan (1995).

6.2 Cost of Repayment and Default

Repayment rates in microcredit projects are directly related to the level of administrative costs and mobilization efforts (Rahman, 1999). This forces the credit institutes to raise the

interest rate, which is borne by the borrowers. Real interest rates in Grameen Bank hover around 20% while conventional banking structures provide loans at a much lower interest rate. Scholars further argue that a system based on quick repayment of small loans doesn't allow for funds to go into income-bearing activities that have a gestation period of any significance. The repayment record also slackens as the size of the loan increases or the frequency of borrowing rises. Prompt and regular repayment largely occurred through cross-financing from other sources of credit and not through returns from the investment undertaken with the loans. This pushes future generations into vicious cycles of debt.

In West Bengal, under the Swarna Jayanti Gram Swarojgar Yojana (SGSY), SHGs are provided access to credit by opening up a Cash Credit (CC) account. The main emphasis of the program is organizing the poor in SHGs and to augment their capacities for taking up economic activities for the generation of income. Cash credit accounts can only be opened only after the capacity of the SHG to manage the fund and are assessed through a gradation exercise by the banks and government officials. Gradation exercise often takes up a lot of time to absorb higher doses of credit. Premature lending may lead to poor returns from the venture or loss of an asset.

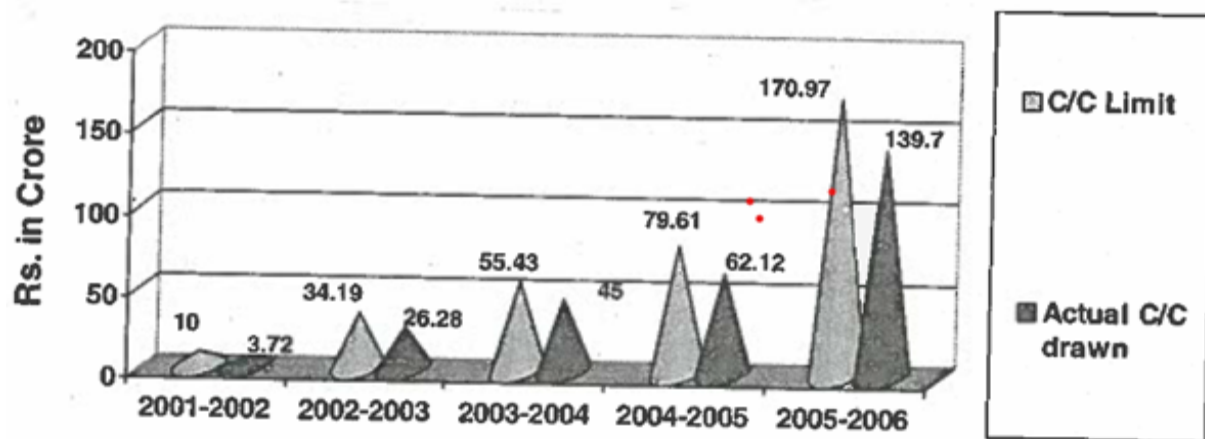


Fig. 3. Year-wise Cash Credit Limit and actual amount drawn by SHGs on cumulative basis

Source: *Microcredit: A West Bengal Perspective* by Bhattacharya, Mojumder & others (2008)

Minimizing the costs of default is crucial for the sustainability of any credit provision program or institution. In West Bengal, Swaminathan (1990) found that the local bank reported a default rate on IRDP loans of about 45%. Given the low capital intensity of investments made through microcredit and the resultant low-profit margins, a high rate of interest dampens the possibility of any significant savings on the part of the poor borrowers. The enthusiasm of banks to lend to these SHGs and the increasing importance of 'quantitative targets' have led to a clear decline in the quality of groups that are being linked with it.

7.0 Conclusion

Localized NGO-led microcredit schemes and institutions such as Grameen Bank in Bangladesh have been successful in reaching their target groups of poor more effectively than large-scale state-led programmes such as SGSY. Both have had a marginally positive impact on the income of the beneficiaries while smoothing and stabilizing their consumption patterns. The number of days of employment has gone up but performance in generation of wage employment remains dismal. Micro-Level studies in West Bengal seem to suggest that association with local governments and panchayats helped it identify the potential and eligible beneficiaries more effectively, as a result of which microcredit schemes have performed a lot better in terms of supplementing their income and consumption. The provision of credit has been found to strengthen crisis coping mechanisms, diversify their income sources and build assets. The profitability of NGO-led microcredit schemes might paint a rosy image of its sustainability and scalability of operations. The negative effect of these costs on the profit levels has been counterbalanced, first by raising interest rates on loans, and second, by relying more on subsidies, exposing the fragile financial health of such programs and institutions. Lack of access to credit is significant but not the only constraint faced by the rural poor. An improvement in the living standards of rural poor requires among other things, agrarian reforms, democratic decentralization, public action towards education and health facilities, and streamlining of the public distribution network for the poor. A multilevel and multi-pronged approach that includes social safety nets is the need of the hour to address the regional mismatch between the

The concentration of poverty and that of access to credit. Microfinance and other poverty alleviation programs are complementary rather than substitutes.

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