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Micro Finance and Financial Inclusion of the Poor through Self Help Group Bank Linkage

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Micro finance through self help groups (SHGs) is an innovative approach for the financial inclusion of the rural poor. Credit has been an element in linking factor and commodity markets. Credit helps the rural poor in the acquisition of income generating assets and create self employment opportunities thereby alleviating rural poverty. Self help groups (SHGs) provide an innovative system of financial intermediation to provide micro financial assistance to the rural poor. Access to and control over financial resources mean a command over land, technologies labour, raw materials and markets (ILO-2000).

Micro finance scene in India is dominated by SHG bank linkage programme aimed at providing a cost effective mechanism for providing financial services to the rural poor.

Micro-credit and Micro-finance

The terms micro-credit and micro-finance are often used interchangeably. It is expedient to highlight the difference between the two. Micro-finance is a functional part of financial institutions that is adapted to the needs and realities of those who don't have access to conventional systems. Major functions of micro-finance are the pooling of funds (deposits), risk management mainly through insurance, transfer of economic resources by lending funds and in some cases provides a payment system. Micro-credit is that part of micro-finance that deals with the transfer of economic resources to the poor through the lending of funds borrowed on the financial market or received from donors.

SHG-Bank Linkage (SBL) programme for credit has been able to reduce transaction costs. It has enabled the banks to achieve better loan recovery and mobilize low cost deposits. The SBL has introduced innovation in bank lending by forging flexibility, operationally easy and follow up virtue of informal lending system. This is in view of technical and administrative capabilities and efficiencies and adequate availability of financial resources of formal lending mechanism of commercial banks.

Micro-credit refers to only credit services. Micro-finance is an organized economic development strategy. It offers several types of financial services aimed at assisting large number of low income people establish/grow their small and medium businesses in order to generate sustainable income for the reduction of poverty and achievement of quality life. Services rendered under micro-finance include: a. Promotion of saving culture, b. The provision of credit for working capital, c. Training in business skills, d. Education or health and e. Offering of products such as relevant insurance policies.

Micro-finance takes a holistic view of the poverty in society and designs ways for eradicating it through various services. Micro-credit covers only the provision of small loans without necessarily taking into account issues that affect the loan beneficiary's quality of life. Micro-credit is simply a component of micro-finance programme.

Micro-finance–Institutional Network

Micro-finance institution is an organization that offers financial services to low income populations. These institutions offer micro-credit and take back small amounts of savings from their own borrowers not from the general public. Within the micro-finance industry the term micro-finance institution has come to refer to a wide range of organizations dedicated to providing these services. They include NGOs, credit unions, cooperatives, private commercial banks and non-bank financial institutions and parts of state owned banks.

Emergence of Micro-finance through SHG-bank Linkage: Commercial banks strived to find ways of improving their financial viability. In the wake of increasing transaction costs, mounting overdue payments, Indian banks started showing considerable interest in group based credit programme. Banks started lending to the members of Self Help Groups (with or without NGO intermediation) which undertook

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Table-1

Highlights of the Progress of SHG-bank Linkage Programme (Rs. Million)

Items	March 2001	March 2002	March 2003	March 2004	March 2005	March 2006
No of new SHGs credit linked during the year	149050	197653	255882	361731	539365	620109
Cumulative No of SHGs credit linked with banks	263825	461478	717360	1079091	1618456	2238565
No of SHGs provided with repeat bank loan	NA	41413	102391	171669	258092	344502
Per cent of women groups	90	90	90	90	90	90
No of participating banks	314	444	505	560	573	547
i. Commercial banks	43	44	48	48	47	47
ii. RRBs	177	191	192	196	196	158*
iii. Co-operative banks	94	209	265	316	330	342
No of States/UTs	27	30	30	31	31	31
No of district covered	412	488	502	563	572	583
No of partners	1030	2155	2800	3024	4323	4896
Bank loan during the year	2879	5455	10223	18555	29942	44991
Of (9) above, repeat bank loan to the existing SHGs	NA	924	3318	6978	12676	21686
Bank loan (cumulative)	4809	10263	20487	39042	68985	113975
Refinance (cumulative)	4007	7965	14188	21242	30920	41597
No of families assisted (in million)	4.5	7.8	11.6	16.7	24.3	32.98
Average bank loan/SHG (Rs.)						
New	18227	22918	26985	32004	32012	37582
Repeat	NA	22311	32405	40648	49114	62949
Average bank loan/Member** (Rs.)						
New	1072	1432	1687	2286	2287	2684
Repeat	NA	2541	2025	2903	3508	4496
Model-wise linkage in % (cumulative)						
i. SHGs formed and financed by banks	13	16	20	20	21	20
ii. SHGs formed by NGO and formal agencies but directly financed by banks	76	75	72	72	72	74
iii. SHGs financed by banks through NGOs	11	9	8	8	7	6

Source (NABARD, 2006)

** The actual loan availed by SHG member is higher as this does not include own funds of SHGs

* Merger of some RRBs

the responsibility of selection, monitoring and recovery of loans and repayment to banks (D. Rajsekhar, 2004). Banks lending to SHGs not only obtained refinance from NABARD but also had the advantage of a reduction in the transaction costs, an improvement in recoveries and profit margins lending to wider coverage of the target group (NABARD, 1992). The borrowers also experienced a reduction in transaction costs (Puhazendi, 1995).

SHG-Bank Linkage and Micro-finance in India: SHG-Bank Credit Linkage has been the outcome of the Reserve Bank of India circular of July 24, 1991 and NABARD's guidelines of February 26, 1992. It is an alternative strategy for credit which is not part of official credit delivery system. SHG-bank linkage is a decentralized model where decisions are taken at group level. It is radically innovative and is more than just a complementary strategy. The official credit system of banks has accepted that it can lend money to the group of poor people on the basis of group's performance as an institution. This implies that the official system accepts that SHGs can establish the purpose and size of the loans, the schedules of advances and repayments and the rate of interest.

Models of SHG-Bank Linkage

The credit linkage of SHGs with the banks has three models: Model-I: SHGs formed and financed by banks; Model-II: SHGs formed by agency other than bank – NGOs and others, but directly financed by banks and Model-III: SHGs financed by banks through NGOs and other agencies as financial intermediaries.

SHG-bank linkage has the following major objectives: 1.Evolving supplementary credit strategies for meeting the needs of the poor combining the flexibility, sensitivity and responsiveness of the informal credit system with technical administrative capabilities and financial resources of formal financial institutions. 2.Building mutual trust and confidence between bankers and rural poor and 3. Encouraging banking activity in both the thrift and credit aspects in a segment of the population that formal financial institutions usually find difficult to match.

Progress of SHG-Bank Linkage Programme

There has been tremendous progress of the SHG-Bank Linkage programme over a short span of over one decade. The NABARD publication has reported that more than 16 lakh SHGs have been linked with various financial institutions all over the country. The SHG-Bank Linkage programme has benefited more tham 242 lakh families covering 1212.30 lakh poor people. Details of bank loans and refinance etc. have been provided in the following table for the period from 2001 to 2006.

The details from the above table reveal very significant trends about the progress of the SHG-Bank Linkage programme in India. The following are the highlights of the progress of the programme can be seen in the Table-1.

1.No of new SHGs credit linked during the year rose from 149050 in 2001 to 620109 in 2006, 2.Cumulative No of SHGs credit linked with banks increased from 263825 in 2001 to 2238565 in 2006, 3.No of SHGs provided with repeat bank loan rose from 41413 in 2002 to 344502 in 2006, 4.Women SHGs are 90% of the total during 2001-06, 5.No of participating banks went up from 314 in 2001 to 547 in 2006, 6.Bank loan during the year rose from Rs. 2879 million in 2001 to Rs. 44991 million in 2006, 7.Refinance (cumulative) increased from Rs. 4007 million in 2001 to Rs. 41597 million in 2006, 8.Average-bank loan to SHGs went up from Rs. 18227 in 2001 to Rs. 37582 in 2006 and 9.Average bank loan/member rose from Rs. 1072 in 2001 to Rs. 2684 in 2006.

Conclusion

SHG-Bank Linkage (SBL) programme for credit has been able to reduce transaction costs. It has enabled the banks to achieve better loan recovery and mobilize low cost deposits. The SBL has introduced innovation in bank lending by forging flexibility, operationally easy and follow up virtue of informal lending system. This is in view of technical and administrative capabilities and efficiencies and adequate availability of financial resources of formal lending mechanism of commercial banks.

The results of the evaluation studies conducted by NABARD and other agencies have demonstrated the positive impact of the linkage programme. There is an increase in the loan volume of the SHGs and a definite shift in the loaning pattern of the members from non income generating activities to production activities. There has been near 100 percent repayment performance. There has been a considerable externalization and reduction in the banks burden of assessing individual credit needs sanctioning and supervising credit and monitoring the repayment. SHG intermediation has resulted in the time saving by the bank staff on identification of borrowers, documentation follow up and recoveries.

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