Financial Inclusion in India through SHG-Bank Linkage Programme and other finance Initiatives by NABARD

1. Background:

1.1 What is 'Financial Inclusion’?

"Financial inclusion is delivery of banking services at an affordable cost ('no frills' accounts,) to the vast sections of disadvantaged and low income group. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy."

1.2 Existing Banking System and Financial Inclusion

The banking industry has shown tremendous growth in volume and complexity during the last few decades. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are concerns that banks have not been able to reach and bring vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services. Internationally also efforts are being made to study the causes of financial exclusion and design strategies to ensure financial inclusion of the poor and disadvantaged. The reasons may vary from country to country and so also the strategy but all out efforts are needed as financial inclusion can truly lift the standard of life of the poor and the disadvantaged.

1.2 Financial Inclusion in Indian Context

1.2.1 RBI's Policy of Reserve Bank of India on 'Financial Inclusion' : When bankers do not give the desired attention to certain areas, the regulators have to step in to remedy the situation. This is the reason why the Reserve Bank of India places a lot of emphasis on financial inclusion. With a view to enhancing the financial inclusion, as a proactive measure, the RBI in its Annual Policy Statement of the year 2005-2006, while recognizing the concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, urged banks to review their existing practices to align them with the objective of financial inclusion.

1.3 NABARD and Financial Inclusion

National Bank for Agriculture and Rural Development (NABARD) has designed, developed and has been facilitating SHG- Bank Linkage Programme in India since 1992 with various partner agencies like Banks, NGOs, Government Agencies/ Departments, etc. The SHG – Bank Linkage Programme and other microfinance initiatives by NABARD has contributed much towards financial inclusion process in India.

2. Genesis and Concept of Self Help Group (SHG)

2.1 Despite the phenomenal expansion of the organized banking system in India, a very large number of the poor continued to remain excluded from the formal banking system. The existing banking policies, systems and procedures were not ideally designed to enable the poor to be a part of the formal banking system. Hence, the need for an alternative credit delivery mechanism which would meet the requirements of the poor was acutely felt in the late 1980s.

2.2 In the above backdrop, the National Bank for Agriculture and Rural Development (NABARD) initiated a search for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms, that would fulfill the requirements of the poorest, especially of the women members of such households. The emphasis was on improving the access of the rural poor to an integrated micro finance service covering both savings and credit rather than providing just micro credit facilities. As a wide network of bank branches already existed, the strategy focus was not on creating alternate organisations, but on finding ways and means to improve the access efficiency of the poor to the existing banking network, through design of new products and delivery mechanisms.

2.3 Based on study findings of an Action Research Project, the Self Help Group [SHG] - Bank linkage model was evolved as the core strategy that could be used by the banking system in India for increasing access of the poor to the formal banking system. The strategy involves forming small, cohesive and participative groups of the poor, encouraging them to pool their savings regularly and using the pooled savings to make small interest bearing loans to members and in the process, learning the nuances of financial discipline. Bank credit follows and does not precede this stage.

2.4 The SHG - Bank Linkage Programme was launched by NABARD in 1992, with the policy support of the Reserve Bank of India (RBI), the Central Bank of the country. The programme has been designed and nurtured by NABARD for over 15 years.. The pilot phase was followed by the setting up a Working Group on NGOs and SHGs by the RBI in 1994 which came out with wide ranging recommendations on SHG - Bank Linkage as a potential innovation in the area of banking with the poor. The programme was mainstreamed with banks in 1996. *The main objective of the programme has been financial inclusion by extending outreach to poor households in rural areas, making available credit services at their door step with easy and self managed access to formal financial services* on a sustainable basis and in a cost effective manner.

What is a Self-Help Group ?

A Self-Help Group [SHG] is a small, economically homogeneous and affinity group of 10 to 20 poor persons which comes together to

- *save small amounts regularly*
- *mutually agree to contribute to a common fund*
- *meet their emergency needs*
- *have collective decision making*
- *resolve conflicts through collective leadership and mutual discussion*
- *provide collateral free loans on terms decided by the group at market driven rates*

2.5 The SHG is formed and groomed by a Non-Governmental Organisation (NGO) or a bank branch or a government agency acting as a Self Help Promoting Institution (SHPI). The members are encouraged to collect regular thrift on a weekly to monthly basis and use the pooled thrift to provide interest bearing small loans to needy members. The SHPI trains the members to maintain simple accounts of the collected thrift and loans given to members.

3. NABARD's Initiatives

NABARD has been playing the role of propagator and facilitator by providing conducive policy environment, training anf capacity building besides extending financial support for the healthy growth of the SHG linkage programme.

Over the years, various steps taken in this regard may be listed as under:

- Conceptualisation and introduction of Pilot Programme in February 1992 for linking 500 SHGs with banks after consultations with Reserve Bank of India, Banks and NGOs
- Introduction of Bulk Lending Scheme in 1993 for encouraging the NGOs which were keen to try group approach and other financial services delivery innovations in the rural areas
- Developing a conducive policy framework through provision of opening Savings Bank Accounts in the names of SHGs [though they are informal groups], relaxation of collateral norms, simple documentation and delegation of all credit decisions and terms to SHGs
- Training and awareness building among the stakeholders
- Provision of capacity building support of NGOs/SHGs/Banks
- Mainstreaming the SHG Linkage Programme as part of corporate planning and normal business activity of banks in 1996 and internalising training, monitoring and review mechanism
- Encouraging banks (RRBs and DCCBs) for promotion of SHGs
- Support to NGOs for promotion of SHGs
- Encouraging rural individual volunteers in promotion and nurturing of SHGs
- Close Monitoring
- Dissemination through Seminars, Workshops, Occasional Papers and Print media and
- Constitution of a High Powered Task Force to look into the aspects of Policy and Regulation of microFinance and suggest policy, legal, regulatory measures for smooth, unhindered growth of microFinance sector.
- Setting up a microFinance Development Fund in NABARD for meeting the promotional costs of upscaling the microFinance interventions

4. Trends and Progress of SHG Bank Linkage Programme in India

4.1 Physical and Financial Growth

During 2006-07, the number of new SHGs credit- linked with banks was 0.7 million taking the cumulative number of SHGs credit linked to banks at 2.9 million . The phenomenal outreach of the programme has enabled an estimated 41 million poor households to gain access to micro finance from the formal banking system registering a growth of 24.16 % over 2005-06. Today, Commercial Banks with more than 32,000 rural branches have the largest share (55%) in credit linked SHGs followed by Regional Rural Banks (31%) through their 11,900 branches. More than 3,000 NGOs and other development agencies joined the programme primarily as promoters of SHGs or capacity building agencies.

4.2 Regional Growth and Trends – Correction of Imbalances

The year 2006-07 witnessed the spread of the SHG Bank Linkage programme in resource-poor regions of the country, indicating a marked shift from its initial concentration in the southern region (Table1). The cumulative share of non-southern regions rose from 29% as on March 2001 to 48 % as on March 2007. In order to reduce the regional imbalance in the spread of the SHG-Bank Linkage Programme, NABARD identified 13 States which have a large population of the poor, for focussed attention. The cumulative number of SHGs credit linked in these 13 states increased from 1million in 2005-06 to 1.4 million in 2006-07. During 2006-07, the number of SHGs credit- linked in 13 priority States constituted 53.9 % in the all India credit linkage of 0.7 million SHGs.

Table 1 : Regional spread of credit linked SHGs

Region	2000-01		2006-07	
	SHGs Credit linked to banks	Per cent to total	SHGs Credit linked to banks	Per cent to total
Northern	9012	3.4	182018	6.3
North Eastern	477	0.2	91754	3.1
Eastern	22252	8.4	525881	17.8
Central	28851	10.9	332729	11.4
Western	15543	5.9	270447	9.3
Southern	187690	71.2	1522144	52.0
Total	**2,63,825**	**100.0**	**29,24,973**	**100.00**

5. Promotional Initiatives by NABARD

During 2006-07, NABARD incurred an expenditure of Rs. 110.7 million on various promotional activities as against Rs 76.5 million in the previous year. The major promotional initiatives are as under :

5.1 Support for Training and Capacity Building

The various training and capacity building programmes supported / conducted by NABARD covers the following :

- awareness creation and capacity building programmes for SHG members in association with identified resource NGOs;
- awareness-cum- refresher programmes for CEOs and field staff of NGOs;
- training programmes for officers of Commercial Banks, Co-operative Banks and RRBs covering exposure visits to banks and institutions pioneering in MF initiatives for bank/ NGO officials;
- visits to nearby SHGs for Block Level Bankers' Committee members;
- programmes for the elected members of Panchayati Raj Institutions to create awareness about the MF initiatives;
- training-cum-exposure visits for new district officials and exposure programmes on microfinance and SHGs for senior Govt. officials, sensitisation programmes for junior level government officials etc.

5.2 Promotional Grant Assistance to Partner Agencies

As on 31 March, 2007, cumulative grant assistance of Rs 475 million has been sanctioned to Self Help Promoting Institutions (SHPIs) to promote 310,000 groups.

6. The Future Thought

6.1 NABARD looks at the future of its micro finance interventions from the perspective of [i] strengthening the existing institutional set up of rural financial institutions by marketing efficient banking tools among the poor, thereby expanding their outreach on a major scale, and [ii] creating a conducive and supportive environment for encouraging and supporting new Micro Finance Institutions (MFIs) or facilitating graduation of existing NGOs into MFIs for bridging the gaps in delivery of rural financial services.

6.2 In pursuance of the above, NABARD has set for itself an ambitious task for providing access to micro financial services to about 50 million rural families by linking 4 million SHGs with the banking system by March 2012. NABARD interventions in this regard would continue in the form of investments in development of human capital through large scale training of SHGs, NGOs and other SHG promoting agencies, banks and other stake holders, systems design, monitoring and infrastructural capacity building in the micro finance sector.

7. The Impact

The impact of microfinance on poverty reduction has been well documented through various independent studies. Several field studies have highlighted the beneficial impact of the linkage programme. It is generally agreed that the impact has been significant. Findings vary depending upon the area and sample size but some of the empirical highlights are set out below.

i. A study supported by NABARD showed that initially 70-80% of poor households use credit for consumption purposes, but within 2 years, an increasing proportion of them use credit for setting up micro enterprises.

ii. A study conducted by MYRADA in Karnataka revealed that income levels per SHG member had increased substantially over a period of 3 years. Standards of living had also improved significantly. Members had constructed/repaired houses, worked together to keep community areas clean and many had acquired literacy skills. Members could almost eliminate dependence on money lenders. They had also created certain community assets viz., buildings, bullock carts, sprayers, etc., through their savings and assistance from the NGO. The biggest impact on the lives of the members was their social empowerment. They had acquired a level of confidence, awareness and pride in themselves. They were able to demand various types of services from external agencies. Poor households have experienced that banks were now responding to their financial needs.

iii. Another impact evaluation study by NABARD [2001] had found that 86% of the members of the SHGs belonged to the weaker sections of the rural economy. On account of the linkage programme, the value of the assets of the group members had increased by 59%. There was three fold increase in the average annual savings of each member and doubling of borrowings per annum. Besides, the members had improved their communication skills, learnt to handle problem situations and there was a general increase in the self-confidence levels .

iv. There are reports that households that have access to microfinance spend more on education than non-client households. Improvement in school attendance and the provision of educational material have also been reported. A recent study from Tamil Nadu shows that participation in credit and savings programmes has enabled families to send several children at a time to school and has also reduced drop-out rates in the higher primary grades.

v. The SHG movement in India has led to empowerment of rural women both economically and in terms of more equitable gender relations. Most of the study findings are unanimous in acknowledging that membership in SHGs had brought gains for women in knowledge and awareness of the external world and in specific skills. It has been agreed that women's responsibility and public participation has increased, they having acquired both voice and visibility. Women now play a bigger role in household decision- making .The enormous increase in self-confidence and their ability to articulate in public fora are seen as a major achievement for most women.

vi. In certain areas microfinance has reduced child mortality, improved maternal health and the ability of the poor to combat disease through better nutrition, housing and health, especially among women and clients.

vii. On the basis of a sample study of 60 SHGs in Eastern India, researchers have reported positive impact of microfinance on expenditure for production purposes, inclusion of socially backward classes, decrease in violence against women and a gradual shift of households from below to above the poverty line.

viii. The linkage programme has helped in credit delivery to tenant farmers and was found to be working well even in areas affected by left-wing militancy.

ix. The linkage programme had considerable impact on the attitudes of bankers and their business. Whereas in traditional banking, the Branch Manager devoted more time evaluating loan documents backing the application for loan, SHG lending required him to attend group meetings, interact with members and then finalise his lending opinion. These interactions have a lasting motivational impact on bank officers.

x. A national level study 'Impact and Sustainability of SHG Bank Linkage Program' has recently been conducted by National Council of Applied Economic Research (NCAER) in association with GTZ (German Collaboration). The preliminary findings have also corroborate the above facts.

8. Issues and Challenges

While the SHG-Bank linkage programme has attained the status of a national movement, the financial institutions and other stakeholders face formidable challenges in scaling up the programme in a sustainable manner.

8.1 Issues in SHG – Bank Linkage Programme

Regional Imbalances

The regional spread of the SHG – Bank Linkage Programme is uneven as about 52% of the credit-linked SHGs are located in the southern States of the country. There is a need for a better distribution of group formation and linkage efforts especially in the northern, central, eastern and northeastern States. This is important as these States have a higher concentration of the rural poor. Special surveys and analytical studies need to be taken up in such regions to identify factors affecting the spread and sustainability of SHGs. There is a need to invest more in capacity building programmes in these areas. For this, it is essential to build training capabilities in these regions by identifying or promoting new training institutions that may be trained and guided by training institutions of excellence in other areas.

Livelihood promotion among members of SHGs

Of the total groups financed by banks, there are substantial number of SHGs which are more than three years' old and are well stabilised in their credit and savings operations. Members of these mature SHGs are now in a position to scale up and diversify their income generating activities. Many NGOs are trying to promote micro enterprises among SHG members. But their experience is rather limited. The critical constraining factor is that SHG members face a lot of problems in marketing of their produce besides low level of skills. There is a need to evolve a methodology for promoting micro enterprises to create livelihood and employment opportunities among SHG members besides imparting relevant skills and developing their risk taking abilities. The problem of rural migration which is a cause of concern could, among others, be addressed through this intervention. Pilot projects through professional marketing agencies have shown encouraging results.

System for monitoring of SHGs

With a view to improve the information base and introduce data based monitoring at the SHG level, there exists a need to draw up a time bound programme for upgrading quality of book keeping and introducing an MIS which provides timely and accurate record of transactions. The use of mobile handsets and server could provide a technology platform for recording transaction. However, there is a need for systematic monitoring of SHGs so as to maitain high loan recovery level.

Capacity Building of SHG Members

It has been observed that among SHGs, in case there is withdrawal of promoting institutions, there is a tendency for a slip in performance. The solution lies in nurturing of groups upto a point where it becomes self managed and independent of promoting institutions. This implies setting up of proper system for accounts keeping and auditing, credit management, capacity building, skill upgradation, etc.

Currently, there is a significant emphasis on capacity building for bankers, NGOs and Government officials involved in promoting and financing SHGs. The time has come when there is a need to focus on capacity building of SHG members as many of the SHGs are maturing and the business levels of the groups are increasing. There is a need to identify ways and means of improving the quality of SHGs consistent with rapid growth and balancing sustainability with easier financial access.

Low bank loan per SHG member

Under SHG-Bank Linkage Programme, the average size of bank loan per SHG is low at Rs.61,679 which translates to Rs. 4,405 per member. However, the variation at field level shows that the older SHGs which have already availed multiple loan cycles, the average loan per member is in the range of Rs. 25000 to Rs. 40000. In general, small per capita loans do not enable the members to overcome poverty or acquire capital assets. While the criticism is valid, it needs to be emphasised that the clientele under the programme covers the lowest segment of rural society. This segment suffers from various handicaps including low level of skills, illiteracy, poor access to information etc. All this manifests in significantly lower credit absorption capacity. Nonetheless, the challenge remains for all the stakeholders viz. Govt., bankers, NGOs etc. to join hands in the collective efforts for the economic upliftment of SHG members through various repeat cycles of credit infusion.

Micro insurance products

SHG members still do not have access to insurance services, which are crucial for security and sustainability of these groups. According to a study conducted in 2003, over 82% of households surveyed did not have any insurance cover and practically none of the poorest households surveyed, had any insurance policy. There is a serious need to introduce micro insurance products and bring together various players in the insurance sector for supporting pilots for development of composite insurance products, which cater for life, health, crops, assets and accidents. Such a product which could be subsidized as a welfare measure by the Government for SHG members would be ideal for the poorer segments of the rural population who cannot invest in multiple insurance policies.

Emergence of Federations

Another challenge to the SHG-Bank Linkage has been the emergence of SHG Federations. Although, such Federations represent the aggregation of collective bargaining power, economies of scale, and are a fora for addressing social & economic issues, there is evidence to show that every additional tier, in addition to increasing costs, tends to weaken the primaries. Moreover, their sustainability is constrained by several factors, both internal, related to the federations themselves and external, related to the other stakeholders. Considering the emerging role of the SHG Federations and their value addition to SHG functioning, NABARD has decided to support the Federations of SHGs on model neutral basis.

Technology for financial inclusion

As a large number of the weaker and disadvantaged sections of rural society suffer from financial exclusion, there is a need to bring about financial inclusion using technological inputs, on a massive scale, over the next 5 years. This means that every rural family will have at least one member of the household with a bank account. This ‘no-frills’ bank account is expected to enhance access to deposit account, low cost credit, micro insurance, safe money transfers, and financial counseling.

Financial inclusion, as envisaged above, will bring in enormous business volumes, large number of additional customers as also manifold increase in banking transactions. This would require application of cutting edge technology to deliver such services efficiently while simultaneously complementing human efforts. Technological innovations such as smart cards, biometric IDs, mobile handsets and rural kiosks that can help control costs are crucial for a safe and rapid scale up. Pilot projects on various technological interventions in rural areas are already underway.

8.2 Issues in Micro Finance Institutions (MFIs)

- **Functioning and Sustainability of MFIs**

A vast of MFIs in India are non-profit MFIs which are registered as Societies or Trusts, under the Societies Registration Act, 1860 or the Indian Trust Act, 1882. These Acts provide relative ease of registration, have no minimum capital requirement, prescribe no capital adequacy nor any prudential norms. Accountability is structurally limited in case of these legal forms as they are not designed for running financial entities.

- Majority of the MFIs deliver only loan products through groups. Both Self Help Group model as well as Grameen approach is adopted by MFIs for purveying loans.
- The analysis of 36 leading MFIs (partners of SIDBI) revealed that:
  - 77% were registered as societies and trusts, 8% as cooperatives, 6% as companies and 9% as NBFCs
  - Volume of business was small, only 5 MFIs had loan outstanding more than Rs.200 million.
  - 89% MFIs were subsidy dependent.
  - Only 9 MFIs (25%) were able to cover more than 80% of their costs.
  - High share of savings to loan outstanding, long experience, right type of organization form and high repayment rates, etc. tended to improve operational self-sufficiency.

- Majority of the MFIs are young (average experience of about 5 years) and small with loan outstanding less than Rs.10.0 million. They mostly enjoy good reputation among clients and have confidence of local communities.

9. The Way Ahead

9.1 The Bottom of Pyramid (BoP) customer segments do need small doses of finance and in the absence of any alternatives, depend on the unorganized financial system, which utilizes local knowledge, operates flexibly, and offers finance for a wide variety of purposes, though at a very high cost. Banks, therefore, need to think in terms of designing their products in such a manner that they are able to cater to the needs of BoP customers. Banks also need to have flexibility in terms of working hours, documentation, mode of interactions and transactions and need to explore ways to generate and utilize local knowledge and information for effective loan monitoring and risk mitigation.

9.2 **The problem of financial exclusion can be tackled** by banks by recognizing that the poor are bankable; the poor are credit worthy and the poor are good credit risks. On the borrower side, every effort must be taken to eliminate the mistrust, which most of the households have about formal financial institutions. It is essential to develop policies with well-structured incentives. There are major opportunities for offering both deposits and loan products to this population segment. In dealing with such needs, the banks have to look for new delivery mechanisms. These must economise on transaction costs and provide better access to the currently under-served. The focus on financial inclusion has to come from the recognition that this serves the interests of both civil society and the banking system. This would also require suitable policy measures and enabling regulatory guidelines by the State/Central Governments and the Reserve Bank of India.

9.3 The move towards inclusive financing is indeed a big challenge for the financial system. Besides banking, insurance companies too would be required to target BoP customers. Through specially designed products, if insurance companies can provide risk mitigation and sharing mechanism for the target customers, micro insurance would be able to complement the funding efforts of the banks and help the SHG members avail of cheaper insurance in a group mode. Individual micro insurance policies also need to be made available.

9.4 **To conclude,** banks have a large number of outlets in the rural area and it may be further increased. With enabling technology support, the delivery channels could be enhanced with reduced transaction costs. With the introduction of core banking solutions, in most of the major banks, there is huge surplus of available manpower. This, surplus manpower, needs to be reoriented to take up the challenge of addressing the needs of the rural masses and bringing them into the banking fold. However, with the collective effort from banks, regulators, the Government, SHGs & voluntary sector, more of the rural poor can be brought within the ambit of financial inclusion. Banks have an important role to play and a stake in inclusive banking, as it would be a necessary intermediate step towards inclusive economic growth.

10. The Final Word

About Financial Inclusion, in the Annual Policy of the Reserve Bank of India (2004-05), RBI Governor, Dr. Reddy observed -

- *“There has been expansion, greater competition and diversification of ownership of banks leading to both enhanced efficiency and systemic resilience in the banking sector. However, there are legitimate concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, in particular pensioners, self-employed and those employed in unorganised sector. While commercial considerations are no doubt important, the banks have been bestowed with several privileges, especially of seeking public deposits on a highly leveraged basis, and consequently they should be obliged to provide banking services to all segments of the population, on equitable basis.”*

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