

# MICRO FINANCE AND FINANCIAL SUSTAINABILITY OF SHGs

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## ABSTRACT

Micro Finance has gained a lot of significance and momentum in the last decade. It is a novel approach to "Banking with the poor". In this approach, bank credit is extended successfully to the poor through Self Help Groups (SHGs), Non- Government Organizations (NGOs), Credit Unions etc. India now occupies a significant place and a niche in global micro finance through promotion of the SHGs and the home-grown SHG-Bank Linkage Programme (SBLP). Micro credit attempts to combine lower transaction cost and high degree of repayment. This is essentially because of the involvement of potential beneficiaries of rural credit in the credit delivery system. More than 30,000 branches of Commercial Banks, RRBs and Co-operative Banks in over 520 districts in 30 states and Union Territories are now implementing the SBLP, introduced and encouraged by NABARD.

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## INTRODUCTION :

Micro Finance is an economic development approach that involves providing financial services through institutions to low income clients. Micro finance is the provision of thrift, credit and other financial services and products of very small amounts to the poor for enabling them to raise their income levels and improve their living standards. Micro finance helps the poor people to meet their needs for small credit and other financial services. The beginning of the micro finance movement in India could be traced to the Self-Help Group (SHG)

- Bank Linkage Programme (SBLP) started as a pilot project in 1992 by National Bank for Agricultural and Rural Development (NABARD). This programme has emerged as the most popular model of micro finance in India. Other approaches like micro finance institutions (MFIs) also emerged subsequently in the country. Recognizing the potential of micro finance to positively influence the development of the poor, the Reserve Bank, has taken several initiatives over the years to give a further fillip to the micro finance movement in India.

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### **OBJECTIVES OF THE STUDY:**

The Broad objective of the study is to analyze and present the trends and patterns of micro finance with reference to financial sustainability of SHGs. However, this broad objective has been grouped into the following:

- To discuss the objectives, principles and methods of micro finance.
- To study the different types micro finance initiatives.
- To examine the SBLP and its advantages.
- To analyze the progress of SBLP with reference to the growth rate of number of SHGs, bank loans and refinanced by banks in India.
- To present the agency-wise SBLP position to highlight which agency has maintained good position in financing SHGs.
- To identify the financial sustainability of SHG's.

### **OBJECTIVES OF MICRO FINANCE:**

The primary objective of micro finance is supply of loans, savings and other basic financial services to the poor people in developing countries. However, the following are the objectives of micro finance:

- To offer cost effective approach to formal institutions for expanding outreach to poor.
- To promote self employment.
- To reduce debt burdens and break the cycle of poverty.
- To decrease socio-economic inequality among different sections of the society.
- To occupy a significant place in global micro finance through promotion of Self Help Groups (SHGs) and SHG Bank Linkage Programme (SBLP).

### **PRINCIPLES OF MICRO FINANCE:**

Microfinance encompasses any efforts to increase access to financial services, which poor people currently use or could benefit from using. It is generally agreed that microfinance is about giving poor people a 'hand up', not a 'hand out' by providing them with expanded access to financial services.

The following are some principles of Micro finance:

- It is useful to poor people by raising their income level, building up their assets and cushions themselves against external shocks.
- It builds permanent local institutions and integrates the financial needs of poor people into a country's mainstream of financial system.
- It provides micro credit, micro insurance and money transfer services.
- It brings vibrancy of the market economy to the poorest villages and peoples of the world.
- Microfinance institutions measure and disclose their performance – both financially and socially.

### **METHODS OF MICRO FINANCE:**

The Micro finance methods can be classified into the following two types:

- Informal Financial System (IFS)
- Formal Financial Institutions (FFI)

#### **Informal Financial System (IFS) :**

The Informal Financial System of micro credit is not a new concept in India. Priority sector credit in particular was actually a kind of micro credit. The IFS operates in a localized market, and has the full information about its clients. Because of its low cost structure and compact command area, the transaction cost is low. High interest rates and limited scope of the credit are the limitations of IFS. Moreover, the informal money lenders extend credit mainly for traditional short-term needs they cannot

take part in the long-term investment credit. However, the IFS is quite efficient because it;

- Provides doorstep service at anytime.
- Accepts deposits of any amount.
- Extends credit of any amount for any purpose.
- Does not demand complex formalities.

#### **Formal Financial Institutions (FFIs):**

The Formal Financial Institutions are the extensive traditional sources of micro credit. The FFIs operating from a remote area, thus it lacks the advantages of IFS. This increases both transaction costs and default risks. All these factors come in the way of the development of a stable relationship between FFIs and the micro credit clients. The FFIs are lenders to either the ultimate borrower or to the informal systems or the NGOs. In the collaborative approach the big FFIs deal with small FFIs or Micro Finance Institutions (MFIs).

#### **MICRO FINANCE INITIATIVES:**

Reserve Bank has taken several initiatives with a view to giving a further fillip to the micro finance movement in India. The Reserve Bank of India constituted a 'Working Group on NGOs and SHGs' in the year 1994. Based on its recommendations, banks were advised, that financing of SHGs should be included by them as part of their lending to the weaker sections and that SHG lending should be reviewed at the State Level Banker's Committee (SLBC) and by the banks at regular intervals. In the year 1998, banks were advised by the Reserve Bank of India, that SHGs which were engaged in promoting the savings habits among their members would be eligible to open savings bank account and that such SHGs need not necessarily have availed of credit facilities from banks before opening savings bank account. In the year 1999, the RBI constituted a micro credit special cell in the Bank to suggest measures for mainstreaming micro credit and accelerating flow of credit to MFIs. In January 2000,

all Non-Banking Finance Companies (NBFCs) and Residuary Non-Banking Companies (RNBCs) were advised by the RBI that those NBFCs which were engaged in micro financing activities, licensed under Section 25 of the Companies Act, 1956, and which were not accepting public deposits were exempted from the purview of Sections 45-IA (registration), 45-IB (maintenance of liquid assets) and 45-IC (transfer of a portion of profits to Reserve Fund) of the Reserve Bank of India Act, 1934.

The Reserve Bank of India set up four informal groups in October, 2002. Taking into consideration the recommendations of the groups, banks were advised that they should provide adequate incentives to their branches for financing the SHGs and that the group dynamics of working of the SHGs should be left to them. In June 2004, based on the recommendations of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System, it was announced that in view of the need to protect the interest of depositors, MFIs would not be permitted to accept public deposits unless they complied with the extant regulatory framework of the Reserve Bank. In April 2005, the RBI enabled NGOs engaged in micro finance activities to access the External Commercial Borrowings (ECBs) up to US\$ 5 million during a financial year for permitted end use, under the automatic route. In January 2006, based on the recommendations of the internal group of RBI, banks were permitted to use the services of NGOs/SHGs, MFIs (other than NBFCs) and other civil society organizations as intermediaries in providing financial and banking services through business facilitator and business correspondent models. In April 2006, All Regional Directors of the RBI were advised to constitute a coordination forum comprising representatives of SLBC convener banks, NABARD, SIDBI, State Government officials, and representatives of MFIs (including NBFCs) and NGOs/SHGs to facilitate discussion on the issues affecting the operations in the sector and find local

solutions to the local problems. In April 2008, banks were advised by the Reserve Bank to meet the entire credit requirements of SHG members, as envisaged in the Union Budget, 2008-09.

#### **SHG-BANK LINKAGE PROGRAMME (SBLP):**

Self Help Group-Bank Linkage Programme (SBLP) in India launched as a pilot project in 1992. This project was launched by NABARD after extensive consultations with Reserve Bank, commercial banks and Non-Governmental Organizations (NGOs) with the following objectives:

- To evolve supplementary credit strategies for meeting the credit needs of the poor by combining the flexibility, sensitivity and responsiveness of the informal credit system with the strength of technical and administrative capabilities and financial resources of the formal credit institutions;
- To build mutual trust and confidence between the bankers and the rural poor;
- To encourage banking activity, both on the thrift as well as on credit sides, in a segment of the population that the formal financial institutions usually find difficult to cover

The SHGs were expected to facilitate collective decision making by the poor and provide 'doorstep banking', the banks as wholesalers of credit, were to provide the resources, while the NGOs were to act as agencies to organize the poor, build their capacities and facilitate the process of empowering them. It was expected that the pilot project would prove advantageous to both banks as well as the SHGs. The banks would gain by a way of reduction in their transaction costs due to reduction in work relating to appraisal, supervision and monitoring of loans. The SHGs would benefit by getting access to a larger quantum of resources, as compared to their meager corpus generated through thrift. The banks were expected to provide credit in bulk to the group and the group, in turn, would undertake

on-lending to the members. The quantum of credit given to the group by the bank would be in proportion to the savings mobilized by the group and could vary from 1:1 to 1:4. It was prescribed that the purposes for which the group would lend to its members should be left to the common wisdom of the group. The rate of interest to be charged by the SHG to its members was also left to the group to decide. The pilot project envisaged linking of only 500 SHGs to banks. By the end of March 1993, 225 SHGs were actually linked. The pilot project was a success with the figure reaching 620 at the end of March 1994.

The programme has since come a long way from the pilot project of financing 500 SHGs across the country. It has proved its efficacy as a mainstream programme for banking with the poor, who mainly comprise the marginal farmers, landless laborers, artisans and craftsmen and others engaged in small businesses such as hawking and vending in the rural areas. The following are the main advantages of the programme:

- Timely repayment of loans to banks;
- Reduction in transaction costs both to the poor and the banks;
- Doorstep "saving and credit" facility for the poor;
- Exploitation of the untapped business potential of the rural areas.

This programme was started as an outreach programme has not only aimed at promoting thrift and credit, but also contributed immensely towards the empowerment of the rural women. Under the SBLP, the following three different models have been emerged:

- SHGs promoted, guided and financed by banks.
- SHGs promoted by NGOs/ Government agencies and financed by banks.

➤ SHGs promoted by NGOs and financed by banks using NGOs/formal agencies as financial intermediaries.

**PROGRESS OF SHG BANK LINKAGE PROGRAMME:**

Now it is proposed to examine the pattern and trend in the growth rate of number of SHGs, bank loans

and refinanced by the banks in India with a view to point out the progress of micro-finance.

The SBLP has made considerable progress since its inception in the early 1990s, both in terms of the number of SHGs credit linked with banks as also the bank loans disbursed by SHGs. The table-I presents the combined data of SHGs financed by banks, bank loans and refinance from 1999-2000 to 2007-08.

**Table I: PROGRESS OF SHG BANK LINKAGE PROGRAMME**

Year	Total Number of SHGs financed by Banks (in '000)		Bank loans (Rs. In crores)		Refinance (Rs. In crores)	
	During the year	Cumulative	During the year	Cumulative	During the year	Cumulative
1992-99	33	33	57	57	52	52
1999-00	82 (148.5)	115 (248.5)	136 (138.6)	193 (238.6)	98 (88.5)	150 (188.5)
2000-01	149 (81.7)	264 (129.6)	288 (111.8)	481 (149.2)	244 (149.0)	394 (162.7)
2001-02	198 (32.9)	462 (75)	545 (89.2)	1,026 (113.3)	395 (61.9)	790 (100.5)
2002-03	256 (29.3)	718 (55.4)	1,022 (87.5)	2,048 (99.6)	622 (57.2)	1,412 (78.7)
2003-04	362 (41.4)	1,080 (50.4)	1,856 (81.6)	3,904 (90.6)	705 (13.3)	2,118 (50.0)
2004-05	539 (48.9)	1,619 (49.9)	2,994 (61.3)	6,898 (76.7)	968 (37.3)	3,086 (45.7)
2005-06	620 (15.0)	2,239 (38.3)	4,499 (50.3)	11,397 (65.2)	1,068 (10.3)	4,153 (34.6)
2006-07	1,106 (78.4)	3345 (49.4)	6,570 (46.0)	17967 (57.7)	1,293 (21.1)	5,446 (31.1)
2007-08	740 (-33.1)	4085 (22.1)	4,228 (-35.6)	22195 (23.5)	1,616 (25)	7,062 (29.7)

**Source:** NABARD. Figures in brackets indicate percentage variations over the year. Data for 2007-08 is provisional.

The analysis of the data reveals that the cumulative number of SHGs credit linked with banks increased sharply from 33,000 in 1992-99 to 1,15,000 in 1999-2000 and further to 4,085,000 in 2007-08. During the above period, the cumulative bank loans disbursed to SHGs also witnessed a sharp increase from Rs. 57 crore in 1992-99 to Rs.193 crore in 1999-2000 and further to Rs.22,195 crore in 2007-08. Total bank loans disbursed were at Rs.4,228 crore, of which repeat bank loans to existing SHGs were at Rs.1,616 crore during the year 2007-08.

The performance of the micro finance movement could be summarized as follows:

- The movement has penetrated into the client groups that a mainstream agency had not reached effectively in the past.
- It has worked under a credit culture which bore a legacy of write-offs and political intervention and has till now proved to be an insular system with very high repayment rates.

- It has added a new set of clients not only the poor, but also, to a large extent, women.
- It has looked at activities other than agriculture helping people to diversify their livelihoods.
- It has worked under a paradigm of social collaterals, trust, and local systems thereby reducing significant amount of transaction costs.

**AGENCY WISE SHG BANK LINKAGE POSITION:**

Micro Finance agency banks are categorized into three types. They are commercial banks, Regional Rural banks and Co-operative Banks. In terms of relative share of different agencies, commercial banks continued to account for the largest share, both in terms of number of SHGs credit linked and bank loans disbursed, followed by regional rural banks and co-operative banks. For the purpose of analysis of agency-wise SHG-Bank Linkage position, the relevant data for the year 2006-07 and 2007-08 presented in the following Table-II.

**Table-II: Agency-wise SHG –Bank Linkage Position**

Agency	SHGs Credit Linked (in '000)		Bank Loan Disbursed (Rs.in Crores)	
	2006-07	2007-08	2006-07	2007-08
Commercial Banks	572 (52)	312 (42)	3,919 (60)	2,043 (48)
RRBs	381(34)	241(33)	2,053 (31)	1,599 (38)
Co-operative Banks	153 (14)	187 (25)	599 (09)	586 (14)
<b>Total</b>	<b>1,106 (100)</b>	<b>740 (100)</b>	<b>6,570 (100)</b>	<b>4,228 (100)</b>

**Source:** NABARD. Note: Figures in brackets are percentage shares in the respective total. Data for 2007-08 are provisional.

The analysis of data highlights that the commercial banks have maintained lion's share in financing SHGs as their share registered at 60 percent in the

year 2006-07. However it was declined to 48 per cent from 60 percent in the year 2007-08. The share of RRBs and Co-operative banks in SHG linkage increased marginally form 31 per cent to 38 per cent and 9 per cent to 14 per cent respectively over the period under review.

The total number of SHGs financed by Co-operative banks increased sharply from 153 in 2006-07 to 187 in 2007-08 reflecting a significant interest being evinced by many Co-operative banks.

**BANK LOANS OUTSTANDING UNDER SBLP:**

The relevant data for bank loans outstanding under SBLP, as on March 31, 2007 is presented in the following Table-III:

**Table-III: Bank Loans Outstanding under SBLP**

Agency	No. of SHGs	Loans Outstanding (Rs. in Crores)
Commercial Banks	1,893,016(65.4)	8,760(70.8)
Regional Rural Banks	729,255(25.2)	2,802(22.7)
Co-operative Banks	272,234(9.4)	804(6.5)
<b>Total</b>	<b>2,894,505(100.0)</b>	<b>12,366(100.0)</b>

**Source:** NABARD. Note: Figures in brackets are percentages to the respective totals

As on March 31, 2007, 2.9 million SHGs had outstanding bank loans of Rs.12,366 crore under the SBLP. The more number of SHGs at 65.4 per cent had outstanding bank loans at 70.8 per cent with the Commercial banks, similarly 25.2 per cent of SHGs had outstanding loans by registering 22.7 per cent with RRBs. Whereas, only 9.4 per cent of SHGs had outstanding bank loans at 6.5 per cent with the Co-operative banks.

**FINANCIAL SUSTAINABILITY OF SHG's:**

The SHG's provide the members with a launching pad to gain confidence, skills and power to promote their interests. Financial supporting through bank-linkages per independent SHG promoting institutions and SHG's, which are self managed and have the potential to the self sustaining. To enable the SHG's to perform their multifaceted empowerment role, it is necessary that they are operationally and financially supported by micro-finance institutions and other agencies. The studies conducted by the Department of Economic Analysis and Research of NABARD to investigate the impact of SBLP on incomes, poverty reduction and several aspects of

living conditions of SHG member households. The following facts are evident to identify the financial sustainability of SHG's:

- Most of the SHG members substantially increase their saving rates.
- In borrowing patterns of SHG members a shift can be observed overtime from consumption loans to loans for income generating purposes.
- Increased savings and capital formation improve the self financing capacities and even out the household's cash flow, thus creating higher risk absorption capacities and decreased vulnerability.
- The access to formal financial service also contributes to a strongly reduced dependency on informal money lenders with positive effects on the reduction of capital cost.
- The improved access to financial service benefit households and individuals in maintaining, intensifying and diversifying their economic activities, also in the non-agriculture sector with positive effects on income and employment generation.

- The financial services and their impact on income raise the capacities of the beneficiaries of the programme to increase their household expenditure for basic needs such as better nutrition, education and health.
- Most of the clients are SBLP being women, contribute substantially to human capacity building and empowers women to become more self confident and competent.

### **CONCLUSION**

Micro finance acts as a catalyst in the lives of the poor. It provides small loans to the poor as capital through Self-Help Groups. This small amount is used by the poor to become an entrepreneur and improve their living standards. Self-Help Groups as a unit function in both deposit mobilization and in the loan transactions. The members in the SHGs will identify the needy and cooperate with one another to take a loan and in turn help the individual to earn. They also help the individual to repay. The Government should be able to implement various development programmes through these SHGs and try to avoid creating new SHG and also avoid the competition between SHGs.

SHG-Bank Linkage Programme achieved a phenomenal growth over the years. Still there is a large segment of society that is denied access to financial services. An estimate suggests that only twenty per cent of the low income group population has access to financial services. Thus, there is an urgent need to widen the scope, outreach as also the scale of financial services to cover the unreached population.

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