

# Enhancing Financial Inclusion: The Catalytic Role of Self Help Groups

*A large section of rural population does not have any access to formal credit. The exclusion of such a vast segment of the population warranted a new form of intermediary and in response to this self help groups emerged in India. Whether SHGs could be an effective intermediary in bringing more financial inclusion is studied in this article. It is observed that financial inclusion through SHG efforts has a tremendous potential, but there is the need of increasing effort by NGOs, state governments and MFIs and banks. To enhance the ambit of inclusion through the SHG format other products like micro insurance and money transfer services also need to be introduced along with lone credit facility.*

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## Introduction

Financial empowerment of the poor masses is *sin-quo-non* to more entrepreneurship and large employment, which influence economic development. Being instrumental in this process of empowerment, financial intermediaries play a role of catalyst in channelling resources from surplus householders to deficit ones. More particularly their role is more crucial in case of developing economies. In India it seems that the concerted effort of increasing financial inclusion by rapid expansion of government controlled financial institutions has not so far yielded the desired result. Despite the presence of a large number of credit delivery outlets of nationalised banks, regional rural banks, and cooperative banks the rural unprivileged class in particular does not have the access to the minimum financial services. Financial exclusion appears to be more visible than inclusion. Lack of income generation activities in rural areas, grim employment scenario, high level of poverty and other social handicaps are some of the end products of the former. It is increasingly felt that the existing financial infrastructure is inadequate and ineffective in providing necessary

financial services and there is an exclusion of rural society by the formal financial network, which is detrimental to a holistic economic growth.

Of late the emergence of Self Help Groups (SHGs) in delivering the necessary small finance to the economically poor sections of the society has brought some hope. Considering SHGs as rudimentary financial entities, which mediate between the ultimate borrowers and the suppliers of finance i.e. micro finance institutions (MFIs)/banks, their role seems to be very crucial in bringing more financial inclusion.

## Financial Exclusion

To understand financial inclusion it is imperative to know the nature and causes of financial exclusion. It is the process by which individuals are unable and/or unwilling to access mainstream financial providers. It is because of lack of accessibility of formal credit channels due to their location at a large distance from the households, poor physical connectivity in the rural areas, and most importantly the meager financial strength of the household, which at the first instance dissuades it from going to the providers of finance. Sometimes the rigid procedures of financial provisioning also hinder the ability of the household to a great extent. No bank

account, no savings, no insurance, no affordable credit and no financial education/consultancy are however considered as the indicators of financial exclusion.

As a whole this exclusion brings many negative effects on the households as well as the society. First, the movement of economy from cash-based to financial instrument-based, like cheques, debit/credit cards, etc. put certain restrictions or create obstacles to access many services. Second, the safeguards available to bank consumers like insurance cover, locker facilities etc. are also not accessible. Third, operating solely on a cash budget also leave households more vulnerable to loss or theft. Fourth, exclusion tends to bring money lenders into the financial affairs of the households, who suck them in form of exorbitant interest rate and large amount of collateral security. This tightens their grip over the financially poor households. This ultimately reduces families' disposable income thus reduces the amount of savings and the capacity of potential entrepreneurs to start new businesses.

Many factors could be attributed to financial exclusion. Information asymmetry both on the part of providers (who cannot accurately assess potential profitability) and of the financially excluded (who may assume they will be refused access to mainstream financial services even without applying is one of the factors contributing to more exclusion. Apart from this, sometimes individuals do prefer to stay away from formal system because the costs of transacting with the formal credit agencies turn out to be more than the benefits derived from it. This is more visible when the amount of financial requirement is very small. Lack of physical accessibility to banking outlets and procedural difficulties associated with bank transactions in many cases, force rural masses not to approach the formal channels. Contagious effect is

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also one of the causes of exclusion in rural areas. Pressure from peer groups, either because of poor financial awareness or due to the possibility of denial of loan by village lenders in contingent situations force many to stay away.

### **Financial Inclusion**

Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups (Leeladhar, 2006). It is the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded (Throat, 2006). As per the Spending Review (Govt. of UK, 2004) increasing the financial accessibility is the key to more inclusion which is indicated through access to banking; access to affordable credit; and access to free face-to-face money advice. Similarly, the committee on financial inclusion chaired by C Rangarajan defines it "as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.

The holistic view is financial infrastructure as a whole should be more responsive to the needs of the unprivileged sections of the society so that they get an opportunity to access minimum financial services at affordable cost. This can be facilitated either by the government driven effort or by the voluntary initiatives of the banks. Efforts like the Financial Inclusion Task Force of UK and Community Reinvestment Act (CRA) of USA are some of the examples of the initiatives undertaken in other countries to make banking services more inclusive. In the developing world, e.g. Bangladesh, Indonesia, African and South American countries, reaching the poor through micro finance programme is also made

as one of these world wide efforts. Grameen Bank in Bangladesh, Bank Ryat in Indonesia and Banco Sol in Bolivia are some of the successful MFIs around the world who have made tremendous strides towards financial inclusion.

In the Indian context, attempts like establishment of regional rural banks in 1975, expansion of commercial bank branches with an emphasis on rural areas, revamping of cooperative banking structure, directed credit policy like priority sector lending and the recent micro finance effort by National Bank for Agriculture and Rural Development (NABARD), Kisan Credit Card scheme introduced in 1998 and Swarnajayanti Gram Sworozgar Yojana (SGSY) scheme of subsidised finance, are some of the measures in the direction of financial inclusion.

### **The Need of More Inclusive Rural Financing**

Rural finance is the provision of financial services such as savings, credit, payments and insurance to rural population by organizations that exist along a continuum from formal to informal, ranging from commercial banks to informal village-based savings groups. This includes financing agriculture, agro-processing and other rural enterprises, from part-time income-generating activities to full-time micro-enterprises to small and medium size (SME) enterprises (World Bank, 2006). But the question often raised is -why rural financing? The obvious reason is its predominance in the entire population, and the magnitude of the impact on the economy in case it is not adequately addressed. The ramification of neglecting rural sectors in the long run becomes more visible in a developing country like India, where poverty and unemployment persist on a large scale. Despite a satisfactory growth rate at macro-level the rural sector is still languishing under the paucity of timely and adequate finance and financial services.

India, because of its rural dominance is predominantly dependent on it and in some regions/states e.g. northeast India; it is inevitable to have such finance at a larger scale. However, because of the prevailing negative syndrome of the Indian banking system many bankers back track themselves to lend the poor, whom they designate as "not bankable". Also our Banks too feel that the rapid expansion of their branch network is not contributing to an increasing volume of business to meet their high transaction costs and risk provisioning, which even threaten the viability of banking institutions and sustainability of their operations. The search for an alternative mechanism for catering to the financial service needs of the poor was thus becoming imperative.

### **Some Evidences of Exclusion at Macro Level:**

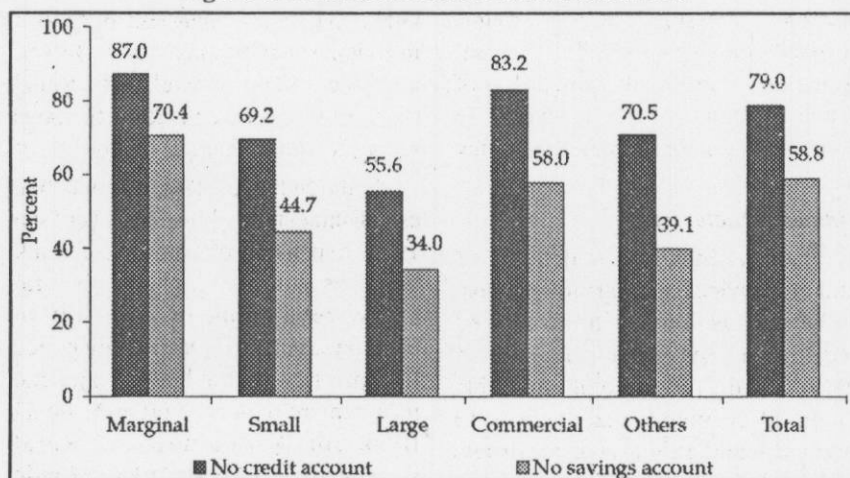
In developing economies, it is widely found that the performance of public financial institutions have been disappointing. Most of the government programs funded by them were unsustainable because they were expensive, yielded little revenue, depended too heavily on outside funding, and often suffered serious default problems. Even worse, a substantial portion of the subsidies was captured by the non-poor who could have obtained loans from the commercial market (e.g. Hoff & Stiglitz 1990; Adams & Pischke 1992). Many public sector banks have been recapitalized, and are found weak with large nonperforming portfolios. A few of them are strong, self-sustaining institutions with the capacity to serve large numbers of rural farm and non-farm clients, including the poorest members of the rural economy (ADB, 2000).

The Indian experience also reveals that the addition of new institutional mechanism to address the issue of rural finance has not helped in improving the situation but rather created new

problems (Agarwala, et al., 1997). A large amount of money of different lending institutions being choked in the rural financing, it is also found that rural credit has been associated with high cost of servicing. Coupled with the poor recovery of rural loans and siphoning of funds by the influential, questions are often raised on the viability of rural financial institutions like RRBs and rural branches of commercial banks. Nevertheless, in recent years there has been a marked improvement in overall banking business with low NPA and good profit margin. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are however concerns that banks have not been able to include vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services (Leeladhar, 2006).

Most sticking imbalances are found in the context of rural vs. urban accessibility of formal channels of credit. Despite more than one lakh credit outlets of banks and cooperative societies for the delivery of agricultural and rural credit at the grass root level in vogue, their present outreach to the poor is still unconvincing. Around 44 percent of the households surveyed by NCAER and World Bank (RFAS, 2003) have borrowed informally at least once in the preceding twelve months; and the interest charged on informal loans averages 48 percent per annum. According to the same survey, some 59 per cent of rural households do not have a deposit account and 79 per cent of rural households have no access to a formal credit source. Indeed, bank branches in rural areas appear to serve primarily the needs of richer borrowers: some 66 per cent of large farmers have a deposit account; and 44 per cent have access to credit. On the other hand, 70 per cent of the marginal farmers do not have a bank account and 87 per cent have no access to credit from a formal

Figure-1: Financial access to rural households



**Note:** Marginal farming households=landholding<1 acre; Small=1 to 4 acres; Large farmers=>4acres; Commercial households= with or w/o land but with income from non-farm sources exceeding half of their total household income; Others=mixed households with land and non-farm commercial incomes but the latter being less than half of their total household income. **Source:** RFAS 2003

source (Figure-1). All these seem to be one of the consequences of financial exclusion.

The analysis of the data provided by the Basic Statistical Returns of Scheduled Commercial Banks reveal that 256 districts, spread across 17 States and 1 UT, of India are found with a credit gap of 95% and above (Report of the Committee on Financial Inclusion, Jan 2008). So far as the supply of necessary credit is concerned, further evidences as found from the sources of RBI show a clear neglect of rural areas by the formal institutional mechanism (Table-1). Over a period of ten years the share of rural areas has decreased in

terms of both the number of branches as well as the amount of credit. The flow of credit to rural India is abysmally low and sometimes scanty. This can be seen from the declining share of agricultural credit, credit to small and village industries which could be attributed to more exclusion. This has encouraged the informal finance sector to flourish even after fifteen years of financial sector reforms.

The above figures clearly reveal that reaching the rural poor whose credit requirements are very small is difficult. Further, the emphasis was on providing credit rather than financial products and services, including savings, insurance,

Table-1: Rural Banking in India: Key indicators (All scheduled commercial banks)

Variable	1995-96	2000-01	2004-06
Total Credit (Cr.)	254015	529272	1513842
Credit flow to Rural Areas (%)	15.2	12.8	8.0
Total Branches (No.)	63026	65919	69471
Branch in Rural Areas (%)	52.4	49.4	44.0
CD Ratio (%)	58.6	53.5	71.5
CD Ratio in Rural Areas (%)	47.3	39.0	52.0
No. of accounts of Rs 25000 credit or less (%)	91.6	71.1	50.0

**Source:** RBI, Basic Statistical Returns for the years 1996, 2001 and 2005

etc. to the poor to meet their simple requirements. The mismatch in perception - regarding how the poor actually use and value financial services - of those who demanded and supplied financial services, even resulted in some undesirable adverse impression in the minds of service providers regarding the credit worthiness of the poor. This was also, aptly rejected by the pioneer of micro finance that they have an inherent skill: "survival skill" (Yunus 1999). It is the presence of this skill that "keeps them alive even when they are poor". Further, the systems and procedures of banking institutions with emphasis on complicated qualifying requirements, tangible collateral, margin, etc., also resulted in a large section of the rural poor shying away from the formal banking sector.

Thus one of the crucial elements in the policy of attacking poverty is the provision of adequate finance and supplying this with hassle free formalities. Despite several measures, the objective of fulfilling the credit needs of the masses and making it viable in the long run has not been achieved. Keeping these requirements in mind, an alternate mode of financing, i.e. micro financing, was envisaged through the intermediation of small groups of borrowers. Evidence from Asia, particularly from Bangladesh and Indonesia, suggests that good, reliable, responsive, long-term MFIs for the poor can go a long way in improving their access to finance (Morduch and Rutherford, 2003). Grameen Bank in Bangladesh, Bank Ryat Indonesia and BancoSol in Bolivia are some of the successful MFIs around the world, formulas of which are being replicated in many developing countries including India.

#### ***Small Groups as Change Agents: Do SHGs help?***

Some of the recent initiatives taken in the context of India to bring more individuals into organized banking

services do provide a scope for more inclusion. These include the efforts made by the Reserve Bank of India like offering 'no frills' account either with 'NIL' or very minimum balances as well as charges that would make such accounts accessible to vast sections of the population, know-your-customer (KYC) policy in order to ensure that persons belonging to low income group both in urban and rural areas do not face any difficulty in opening bank accounts due to the procedural hassles and to provide the details about the charges of different services provided by banks in website. Further, the acceptance of the recommendations of Financial Inclusion Task Force for establishing Financial Inclusion Fund for meeting the cost of developmental and promotional interventions and Financial Inclusion Technology Fund to meet the cost of technology upgradation with NABARD, and incremental allocation to the SGSY scheme in the budget of 2007-08 are some of the recent noteworthy State efforts. But despite many efforts in the last 60 years of our Independence through the establishment of new banks and their branch expansion, and differential interest rates for some classes of population, subsidised finance under different schemes, etc. the problem of financial exclusion remains significant in the areas of banking, affordable credit, and money advice. The costs of this exclusion are wide-ranging and solutions require coordinated effort across the public, private, voluntary and community sectors.

The next question likely to be raised relates to the "change agents"? While it is difficult to single out any specific category, non government organisations (NGOs), MFIs, SHGs, banks, cooperative societies, village councils, panchayats may be collectively bring more inclusion in the long run. Out of all these

interventionists, in India SHGs as a catalyst in social transformation and economic empowerment are found to be more active in recent years. Drawing lessons from the experiments carried out in various parts of the world, particularly in Bangladesh, Sri Lanka, Thailand, Indonesia, Bolivia, Cambodia, Chile and many others, attempts are made to build financial linkages between small informal community groups and formal agencies like banks for catering to the financial service requirements of the poor, especially of the women.

In India after an initial pilot study, the RBI set up a Working Group on NGOs and SHGs in early nineties. The working group made recommendations for internalisation of the SHG concept as a potential intervention tool in the area of banking with the poor. With the launching of SHG- Bank Linkage Programme (SBLP) by the NABARD in 1991-92, SHGs became an effective intermediary of rural financing, even though before this initiative SHGs were already doing such type of intermediation mostly in southern States. Thus alongside bank branch network in the rural areas, SHGs now constitute the grass roots level institutions developed for social/economic and financial intermediation focusing on the poor. NABARD saw the promotion and bank linking of SHGs not merely as a credit programme but as part of an overall arrangement for providing financial services to the poor in a sustainable manner leading to empowerment of the members of these SHGs (Wilson, 2002). The SBLP is "overwhelmingly based on the principle of financial services being related to the cash flows of the low-income client groups and thus aim to facilitate relatively frequent and very small or micro-loan and saving transactions" (Sinha, 2003). Its evolution could be viewed in terms of three distinct phases, viz., (i) pilot testing during 1992 to 1995; (ii) mainstreaming during 1996 to 1998;

and (iii) expansion from 1998 onwards (Reddy, 2005).

The outreach of SHGs as depicted in Table-2 clearly reveals an astounding addition of millions of poor households and individuals to this intermediary. The SHGs have succeeded in reaching to more than 58 million rural families so far. It may be seen that of all the all quantitative dimensions their decadal growth is quite phenomenal. Also, the participation of women in the programme is quite encouraging and has the potential to bring rapid transformation in the rural society. The regional spread of SHGs linkages as depicted in Table-3 however, indicates some of the qualitative features of such programme. The highly skewed figure towards the region like southern India is an indication of either unpopularity of the programme or lack of concerted efforts by various agencies to bring more individuals to the fold of SHG movement in other regions. Looking at the recovery position as depicted in Table-4 it is observed that 73 percent of the total banks have a recovery performance of around 90 percent. Rest of the banks have a poor to very poor performance record. This signifies that many credit linked SHGs are not performing well so that their repayment to the bank is not up to standard. This further indicates the possibility of closing down of many SHGs in the longrun thus jeopardising the efforts of financial inclusion.

**Conclusions**

The existing network of commercial banks, regional banks and cooperative banks is shying away from providing credit facilities to the needy rural households. The emergence of SHGs as financial intermediaries in recent years has raised hopes that rural India could be effectively financially linked. The potential of SHGs in making effective intervention for providing financial services to the rural poor is found to be enormous. Looking at the

**Table-2: Overall outreach of SHGs (Cumulative)**

Variable	March 1993	March 1996	March 2001	March 2007
SHGs linked	255	4,757	2,63,825	41,60,584
Women's groups (%)	70	74	90	90
Families assisted	5,100	80,000	4.5 ml	58 ml
Aggregate bank loans (Rs.)	2.9ml	60.6ml	4809ml	289450ml

Source: Compiled from NABARD data

**Table-3: Region-wise outreach of SHGs**

Year	Region-Item ↓	North	East	Central	West	South	NE	India
2000-01	No of SHGs	9012 (3.42)	22252 (8.43)	28851 (10.94)	15542 (5.89)	187690 (71.14)	477 (0.18)	263825 (100)
	Bank Loan	164 (3.40)	190 (3.95)	257 (5.35)	246 (5.12)	3942 (81.98)	9 (0.19)	4809 (100)
2005-06	No of SHGs	133097 (5.95)	394351 (17.62)	267915 (11.97)	166254 (7.43)	1214431 (54.25)	62517 (2.79)	2238565 (100)
	Bank Loan	3986 (2.79)	9354 (8.21)	8050 (7.06)	5251 (4.61)	85677 (75.17)	1657 (1.45)	113975 (100)
LGR (2001-06)	No of SHGs	68.92	78.07	57.13	56.51	43.32	170.95	51.79
	Bank Loan	87.92	119.19	100.76	82.30	85.17	199.35	88.51

Source: Compiled from NABARD data (LGR: Linear Growth Rates)  
Figures in brackets are share in total of the country for the year. Loan amount is in Rs. million.

**Table-4: Bank-wise distribution of Recovery of SHG Loan**

Agency	Total no of banks reported recovery data	Percentage of distribution of banks as on 31 <sup>st</sup> March 2007			
		95% and above	80-94%	50-79%	Less than 50%
Commercial Banks (Public Sector)	22	22.7	36.4	40.9	0.0
Commercial Banks (Private Sector)	14	42.9	50.0	7.1	0.0
Sub Total	36	30.6	41.7	27.8	0.0
RRBs	73	27.4	47.9	17.8	6.8
Cooperative Banks	181	42.0	30.4	19.3	8.3
Total	290	36.9	36.2	20.0	6.9

Source: NABARD, 2008

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