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# Self Help Group-Bank Linkage Model and Financial Inclusion

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## ABSTRACT

*Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. Microfinance is emerging as a powerful instrument for poverty alleviation in the new economy. In India, microfinance scene is dominated by Self Help Groups (SHGs) - Banks Linkage Programme, which aimed at providing a cost effective mechanism for providing financial services to the unreached poor. Though a variety of microfinance models are followed in India, SHG-bank linkage programme (SBLP) is the predominant one. This paper examines the effectiveness of Indian banking system in the realisation of financial inclusion objective with special reference to SBLP.*

**Keywords:** *SHG-bank linkage programme; Micro finance; Financial inclusion.*

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## INTRODUCTION

Financial inclusion is enabling access to/delivery of banking services at an affordable cost to the vast sections of disadvantaged and low-income groups. Unrestrained access to public goods and services is the sine qua non of public policy of a nation. As banking services are in the nature of public service, provision of banking and payment services to the entire population without discrimination should be the prime objective of the public policy.

Over the last several decades the banking sector in the country has taken significant strides to achieve profitability, financial stability and competitiveness to cater to the increasing demand for financial services. However, much of the benefits accrued due to the growth in banking services have been limited to a minority of the total population of the country. Banks have not been able to reach a vast segment of the population particularly the un-banked and under-banked sections of the society. The spread of banking facilities, though impressive, has been uneven in the country, throwing up challenges for achieving financial inclusion. Thus, despite remarkable growth of branch network in India, the vast sections of the society remain financially excluded and continue to remain away from the formal system and thereby access to financial services including savings, credit and insurance.

## REVIEW OF LITERATURE

A large number of studies often suggest that development of the financial sector and better access to financial services are imperatives for facilitating economic growth. Sahoo & Gopakumaran (2009), through cross country empirical study examined a close relationship between financial inclusion and development. Further, the study found a

positive relation between financial inclusion and different socio-economic variables like income, inequality, literacy, physical infrastructures.

Sanghwan (2006) studied the extent financial inclusion across various states. He also tried to examine the role of SHG bank linkage programme in achieving financial inclusion. The study suggested a significant role of SHG led programme in achieving financial inclusion.

However, not all authors are as enthusiastic about the role of microfinance in development and it is important to realise that microfinance is not a silver bullet when it comes to fighting poverty. Hulme and Mosley (1996), while acknowledging the role microfinance can have in helping to reduce poverty, concluded from their research on microfinance that “most contemporary schemes are less effective than they might be” (1996, p.134). They state that microfinance is not a panacea for poverty-alleviation and that in some cases the poorest people have been made worse-off by microfinance. Rogaly (1996, p.109/110) finds five major faults with MFIs. He argues that:

- ❖ they encourage a single-sector approach to the allocation of resources to fight poverty,
- ❖ microcredit is irrelevant to the poorest people,
- ❖ an over-simplistic notion of poverty is used,
- ❖ there is an over-emphasis on scale,
- ❖ there is inadequate learning and change taking place.

Thus, keeping in view various studies done on financial inclusion, the present paper attempts to scrutinize the role of Indian banking system in the realisation of financial inclusion objective with special reference to SBLP.

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## OBJECTIVES OF THE PAPER

The paper attempt to study the extent of financial exclusion in different states of the country. Efforts are made to study the strength of SHG programme to achieve financial inclusion and evolve a strategy to make use of the same. Endeavour is made to examine the effectiveness of Indian banking system in the realisation of financial inclusion objective with special reference to SBLP. The present paper tries to examine the extent of financial inclusion by self help group bank linkage program against the backdrop of growing regional inequalities which the formal banking system faces across various regions in India.

## RESEARCH METHODOLOGY

Secondary data has been used for this study. The secondary data is drawn from published sources, documents in connection with various legal statutes, official (Government) announcements in the press and the Parliament, records and surveys published by official agencies such as Planning Commission of India, NABARD, local panchayat, etc. Reports of various expert committees submitted to the Government from time to time has also be studied.

Several books, journals, periodicals, reports has also been extensively referred to in the libraries at the Indian Law Institute, the Indian Society of International Law, the Institute of Company Secretaries of India (ICSI), the Institute of Chartered Accountants of India (ICAI), the All India Management Association (AIMA), the Confederation of Indian Industry (CII), the Faculty of Law and the libraries of North and South campuses of the University of Delhi.

To judge the existing state of association between the banking outreach and spread of SHG movement, Karl Pearson's Coefficient of Correlation will be applied. For carrying out these statistical analyses, Statistical Package for the Social Sciences (SPSS) version 16.0 will be used.

## ANALYSIS OF FINDINGS

Today, microfinance is reaching the un-banked and under-banked sections of the society. Microfinance 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. It has been recognised that microfinance helps the poor people meet their needs for small credit and other financial services. It, therefore, holds greater promise to further the agenda of financial inclusion as it seeks to reach out to the excluded category of population from the banking system. The predominant microfinance programme namely Self Help Groups-Banks Linkage Programme (SBLP)

has demonstrated across the country its effectiveness in linking banks with excluded category of poor segments of population.

Self Help Groups (SHGs) are small informal associations created for the purpose of enabling members to reap economic benefit out of mutual help, solidarity and joint responsibility. These small and homogeneous groups involved in savings and credit activities are capable of taking care of the risks through peer monitoring.

The SBLP has emerged as the largest microcredit programme in the world. The SBLP model was introduced in 1991-92 with a pilot project of linking 500 SHGs with banks. This figure has gone up to more than 38 lakh by the end of 2008 (table 1).<sup>1</sup>

**Table 1: Growth trends in SBLP**

|   | 2002     | 2003     | 2004      | 2005      | 2006      | 2007      | 2008      |
|---|----------|----------|-----------|-----------|-----------|-----------|-----------|
| No. of new SHGs provided with bank loans (cumulative) | 4,61,478 | 7,17,360 | 1,079,091 | 1,618,456 | 22,38,565 | 29,24,973 | 38,07,965 |
| Of which in southern region (cumulative)              | -        | -        | -         | 9,38,941  | 12,14,431 | 15,22,144 | 16,74,811 |
| Southern region (%)                                   | -        | -        | -         | 58        | 54        | 52        | 44        |
| No. of New SHGs provided with Bank Loan               | 1,97,653 | 2,55,882 | 3,61,731  | 5,39,365  | 6,20,109  | 6,86,408  | 5,52,992  |
| Of which in southern region                           | -        | -        | -         | -         | 2,75,490  | 3,07,713  | 1,52,667  |
| Southern region (%)                                   | -        | -        | -         | -         | 44        | 45        | 27.6      |

**Source: National Bank for Agriculture and Rural Development (NABARD)**

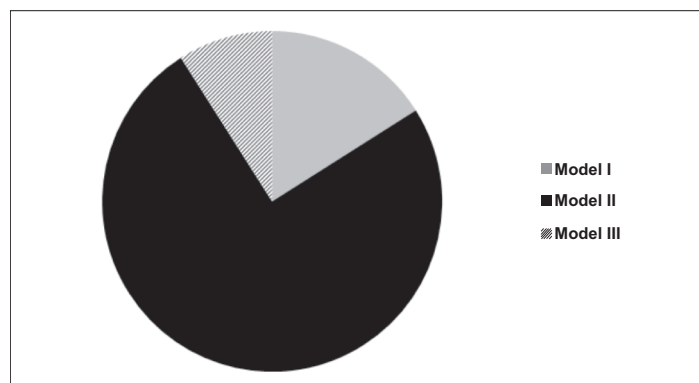
The programme, which started as an outreach programme has not only aimed at promoting thrift and credit, but also contributed immensely towards the empowerment of the rural women. Under the SBLP, the following three different models have emerged:

- ❖ Model I: SHGs promoted, guided and financed by banks.
- ❖ Model II: SHGs promoted by NGOs/ Government agencies and financed by banks.
- ❖ Model III: SHGs promoted by NGOs and financed by banks using NGOs/formal agencies as financial intermediaries.

Model II has emerged as the most popular model under the SBLP programme. Model II accounted for around 75 per cent of the total linkage in 2008, while Models I and III accounted for around 16 per cent and 9 per cent, respectively (Fig 1).<sup>2</sup>

1. Srinivasan, N. (2008): *Microfinance India: State of the Sector Report*, New Delhi: Sage Publications India Pvt. Ltd.

2. NABARD's Annual Reports

**Fig 1: Distribution of SHGs among Different Bank Financing Models**

### BANKING NETWORK AND SHG SPREAD

Banks have been the major drivers of the SHG movement so far in the country. This is becomes apt to study the relation between the SHG spread and banking network (table 2).

**Table 2: Region-wise Banking Network and SHG Spread (2008)**

| Region        | SHG Spread | Banking Network |
|---------------|------------|-----------------|
| Northern      | 156        | 7.9             |
| North Eastern | 283        | 4.6             |
| Eastern       | 274        | 5.0             |
| Central       | 142        | 5.0             |
| Western       | 229        | 6.7             |
| Southern      | 703        | 8.2             |

Source: RBI, NABARD and CSO

To judge the existing state of association between the SHG spread and banking network, Karl Pearson's Coefficient of Correlation is applied. The SHG spread is measured as number of SHGs per lakh population<sup>3</sup>. The banking network is measured as number of branches of scheduled commercial banks per lakh population. For carrying out the correlation analysis, Statistical Package for the Social Sciences (SPSS) version 16.0 has been used.

Though there does not appear to be a one-to-one correspondence between banking outreach and spread of SHG movement, this is captured by the positive correlation of 0.47 found between the two variables (table 3). A striking feature observed has been that even with similar banking network, SHG spread varies between regions and states indicating that other factors are equally important. For instance, at the regional level, similar banking network in the Northern and Southern regions does not translate into comparable SHG spread.

**Table 3: Correlations Among Variables Studied**

|                 |                     | SHG spread | Banking network |
|-----------------|---------------------|------------|-----------------|
| SHG spread      | Pearson Correlation | 1          | .472            |
|                 | Sig. (2-tailed)     |            | .345            |
|                 | N                   | 6          | 6               |
| Banking network | Pearson Correlation | .472       | 1               |
|                 | Sig. (2-tailed)     | .345       |                 |
|                 | N                   | 6          | 6               |

Although impressive gains have been registered in terms of SBLP, the sector still continues to serve only about 10% of the poor in the country and only about 8% of the total estimated demand has been met (Microfinance India Report, 2008).

SBLP was conceived to fill the existing gap in the formal financial network and extending the outreach of banking to the poor. However, the present distribution of the SBLP is skewed against the poorer regions of the country. There is wide regional disparity in the spread of SHGs linked to banks. The Annual Report of the National Bank for Agriculture and Rural Development (NABARD) details that, in 2008, while the Southern region accounted for 44 per cent of the total SHGs, the share of North- Eastern region was just 8.4 per cent (table 4).

**Table 4: Regional Shares in SBLP (2008)**

| Region           | No. of SHG       | % share      |
|------------------|------------------|--------------|
| Northern         | 3,60,740         | 9.4          |
| North Eastern    | 3,19,520         | 8.4          |
| Eastern          | 6,72,626         | 17.7         |
| Central          | 4,05,707         | 10.7         |
| Western          | 3,74,561         | 9.8          |
| Southern         | 16,74,811        | 44           |
| <b>All India</b> | <b>38,07,965</b> | <b>100.0</b> |

Source: NABARD

The reports further reveals that in addition to the inter-regional disparity, there is wider intra-regional disparity among the constituent states in SHG spread. The progress of SBLP has not been homogeneous in any region. In the Southern region, where the programme has been very successful, SHGs per lakh population varied between 891 in Andhra Pradesh and 435 in Kerala during 2008. In the North-Eastern region, the major share was accounted for by Assam with 3.1 per cent of the total SHGs while the rest of the six states in the region had a negligible share in the total SHGs. Similarly, Rajasthan and Himachal Pradesh were

3. Only those States accounting for at least 34,780 SHGs (or 1 per cent of total SHGs linked with banks in India) have been included in the correlation analysis.

distinctly ahead in the Northern region in terms of spread of SHGs. In the Eastern region, SHG spread in Orissa was comparable with the Southern states. There is clear evidence of the fact that the SHG movement in India has spread to other regions/states, though not to the same extent as in the Southern states. However, a major concern remains the scale of finance in the non-southern regions. Further progress in the SBPL needs to reckon these regional variations in the spread of the programme.

The North, Central, Eastern and North-Eastern still have considerable scope for growth. The underlying causes for slow growth of microfinance in these areas is very little demand for credit from the poor and the absence of good quality NGOs, that are willing to initiate microfinance programs in these states (there are a large number of small NGOs but all of them with limited experience and outreach) [Mahajan and Ramola, 2003]. Expansion into remote areas is fraught with risks and additional costs and long breakeven periods; hence the lack of focus on such areas.

In order to reduce the regional imbalances in the spread of the SBLP, NABARD identified 13 states – Assam, Bihar, Chhattisgarh, Gujarat, Himachal Pradesh, Jharkhand, Maharashtra, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh, Uttarakhand and West Bengal, which have a large population of the poor, for focused attention. Due to the intensified efforts in these states, their share in the total SHGs credit linked increased from 31 per cent in 2002 to 47 per cent in 2008 ( NABARD's Annual Reports). Based on the growth rate of SHGs credit linked in 2008, it is suggested that Gujarat, Uttar Pradesh, Jharkhand, Uttarakhand and Madhya Pradesh needs priority attention (table 5).

**Table 5: Growth of SHGs Linked in 13 Priority States**

| <i>Cumulative Number of SHGs Credit Linked in the State</i> |        |          |          |          |          |                     |
|---|--------|----------|----------|----------|----------|---------------------|
| Name of states  | 2004   | 2005     | 2006     | 2007     | 2008     | Growth rate in 2008 |
| Assam   | 10,706 | 31,234   | 56,449   | 81,454   | 1,07,098 | 31                  |
| Bihar   | 16,246 | 28,015   | 46,221   | 72,339   | 93,410   | 29                  |
| Chhattisgarh  | 9,796  | 18,569   | 31,291   | 41,703   | 60,763   | 46                  |
| Gujarat   | 15,974 | 24,712   | 34,160   | 43,572   | 46,526   | 7                   |
| HP  | 13,228 | 17,798   | 22,920   | 27,799   | 31,899   | 15                  |
| Jharkhand   | 12,647 | 21,531   | 30,819   | 37,317   | 42,605   | 14                  |
| MP  | 27,095 | 45,105   | 57,125   | 70,912   | 83,336   | 18                  |
| Maharashtra   | 38,535 | 71,146   | 1,31,470 | 2,25,856 | 3,26,425 | 45                  |
| Orissa  | 77,588 | 1,23,256 | 1,80,896 | 2,34,451 | 3,07,591 | 31                  |
| Rajasthan   | 33,846 | 60,006   | 98,171   | 1,37,837 | 1,73,192 | 26                  |
| Uttar Pradesh   | 79,210 | 1,19,648 | 1,61,911 | 1,98,587 | 2,36,929 | 19                  |
| Uttarakhand   | 10,908 | 14,043   | 17,588   | 21,527   | 24,679   | 15                  |
| West Bengal   | 51,685 | 92,698   | 1,36,251 | 1,81,563 | 2,28,395 | 26                  |

Source: NABARD

Moreover, the smaller size loans generally do not cater to the financial need of the poor client. The loan size significantly differed from region to region. North recorded the largest average loan size of Rs 6,300 with the West having the lowest average loan size of Rs 1,900 (Table 6)<sup>5</sup>. The average loan size in the North was more than three times of the loan size in the Western region.

Surprisingly, the most mature Southern region had a lower average loan size compared to the nascent North.

**Table 6: Region-wise Average Loan Size (2008)**

| Region | Average Individual Loan Size (Rs) |
|--------|-----------------------------------|
| East   | 3,126                             |
| North  | 6,323                             |
| South  | 4,735                             |
| West   | 1,924                             |

Source: Srinivasan, State of the Sector Report 2008

In addition to this, SHGs face problems in dealing with banks. In the midst of rapid upscaling of the SHG linkage, several groups are denied loans or faces delays in dealing with their proposals. Often the banks require the groups to place all their savings with the bank, leaving little scope for internal lending of member's savings. The repeated visits, documentation requirements, lack of time on the part of branch staff to visit the groups in their villages and the lack of continuity of branch staff add to the woes of the groups. These difficulties in securing bank linkage and sustaining the linkage over successive cycles of funding increase the borrower's transaction costs. Banks must find the time to analyse the reasons for these problems and design solutions that work seamlessly in the field.

## RECOMMENDATIONS OF THE STUDY

### WHAT NEEDS TO BE DONE?

Notwithstanding deficiencies, the SBLP augurs well for the tasks of financial inclusion, financial equity as well as efficiency. Some policy suggestions emerging from the above analysis are as follows:

- ❖ Banking network have a significant influence on the spread of SBLP in the states and regions. The number of branches of scheduled commercial banks is lower in the Central, Eastern and North-Eastern regions. It is noticeable that these are also the regions where SHG-bank linkage movement needs to be intensified, particularly in terms of the disbursement of loans to the SHGs linked to banks. In view of the above, policies should incentivise branch expansion in these regions.
- ❖ Banks may have to assume the lead role in taking the

5. Srinivasan, N. (2008): *Microfinance India: State of the Sector Report*, New Delhi: Sage Publications India Pvt. Ltd.



financial services to the vast sections of disadvantaged and low income groups through the mechanism of SBLP. Accordingly, banks need to play a more pro-active role in identification of income generating activities as well as in encouraging NGOs promoting SHGs in the Central, Eastern and North-Eastern regions which could give a fillip to the SBLP.

- ❖ To encourage banks to take keen interest in furthering the SHG movement, perhaps a scheme of performance-linked incentive could be considered. The performance indicator for the banks may be with reference to the credit disbursed under the SBLP in the lagging regions. Further, specific funds may be created to address the regional imbalances in the programme.
- ❖ SHGs need to be encouraged to take up activities of rural infrastructure building such as construction and renovation of minor irrigation tanks, feeder channels, canals and distributaries. This will have salutary effect on agricultural yields in the rain fed areas. Further efforts should be made towards embedding livelihood activities, microinsurance and grain banks in the SHG model.
- ❖ The Report of the Committee on Financial Inclusion (2008), identifies that in several cases, bankers show unenthusiastic attitude in promoting SHGs. Occasionally, they point out reasons like shortage of staff, time, etc. Special training and awareness programme about the model is needed for the branch officials.
- ❖ On an average, per member loans work out to around Rs. 6,000 (Srinivasan, State of the Sector Report 2008). It is believed that such loan amounts are not adequate for pursuing any meaningful livelihood activity. The scale of finance needs to be stepped up especially in the non-southern regions, where it is almost half of that at the All-India level.

## CONCLUSION REMARKS

The non-availability of credit and banking facilities to the poor and underprivileged segments of the society has always been a major concern in India. Accordingly, both the Government and the Reserve Bank have taken several initiatives, from time to time, such as nationalisation of banks, prescription of priority sector lending norms and concessional interest rate for the weaker sections. It was, however, realised that further direct efforts were required to address the credit needs of poor. In response to this requirement, the microfinance movement started in India with the introduction of SBLP. SHG linkages with banks have shown a positive impact and changes in the lives of the poor. Despite certain limitations associated with the model, the banking sector can play a lead and proactive role in ensuring financial inclusion through SBLP. It needs to be emphasized that the financial inclusion is not just about credit dispensation, but its about connecting the people with

the banking system for availing bouquet of financial services including access to payment system. However, creating an appropriate credit delivery system is only a necessary condition. This needs to be supplemented by efforts to improve the productivity of small and marginal farmers and other entrepreneurs so that the credit made available can be productively employed. While banks can also take some efforts on their own to improve the absorptive capacity of the clients, it is equally important for Government at various levels to initiate actions to enhance the earnings capacity of the poorer sections of the society. The two together can bring about the desired change of greater inclusion quickly.

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