Institution Building is a process. As the end result, which it tries to achieve, should shape this process, it is logical to first characterise the kind of institutions that one would like to see emerge from the process. This is the purpose of the present chapter.

What are the main characteristics, which the institutions should exhibit? First of all, the financial institutions that are to be built must be permanently oriented towards the target group. Second, they must be viable over the medium-to-long term. This of course includes the ability to cover their costs. If they are to achieve cost-coverage, they must charge their clients prices for the services they provide which the clients can afford to pay and which are also sufficient to cover the full costs of running the institutions. Third, since the costs of credit extension to small and microenterprises can be very high, the institutions must be able to keep their costs as low as possible. These three criteria - target-group orientation, cost-coverage and cost containment - are every bit as applicable in cases where organisations restrict their focus to the provision of finance to small and microenterprises as they are to cases where lending to small businesses is one of several activities the institutions engage in. The dual requirement that these institutions must cover their costs and keep them as low as possible makes it necessary that, after a limited transition period, they become formal banks which are subject to the full regulatory regime of national banking supervisory authorities.
The next question is whether it is politically acceptable to charge the members of the target group cost-covering prices for the services provided to them. The answer depends on whether the costs can be kept at 'acceptable' levels. If this can be done, then it is fair to charge borrowers effective interest rates that are cost-covering, and they will also be able to afford such prices. Is it feasible to bring lending costs down to 'acceptable' levels? If so, how can this be achieved? The central issue in this context is the credit technology. Given the specific problems involved in lending to small and microenterprises, a credit technology which follows established banking practices and relies heavily on conventional forms of loan documentation and loan collateral cannot be employed successfully in an effort geared to reaching the target group and minimising costs and risk.

An appropriate credit technology for small and micro business lending should eliminate the need cumbersome loan documentation as well as for collateral that the target groups cannot provide. It should rely on a thorough and highly standardised assessment of the individual borrower and her ability to fulfil all payment obligations on time. The economic role of collateral is assumed by the borrower's relationship with the bank, which has considerable value to her and can thus be regarded as an asset. What makes the credit technology so attractive and relevant in the context of small and micro business financing in practice is the fact that it permits the financial institution to learn a great deal about its clients and to translate these learning effects into increases in productivity and cost savings².
The next question concerns the institutional and legal status, the corporate governance and the ownership structure of the financial institutions that one would like to see emerge. In principle, private ownership with an unrestricted profit-orientation appears to be a suitable arrangement for securing an efficient provision of financial services as long as banking supervision functions properly and competition ensures that no single institution is in a position to charge monopolistic prices. Typically however, these two conditions cannot be met in a developing country like India. A financial institution that attempts to provide financial services to the target group such as under consideration, in most cases, enjoys the status of a virtual monopolist. The incentives to make the considerable effort involved in lowering costs might be weak for a virtual monopolist. Though competition may change the situation, but competition does not develop quickly. The other argument against private ownership cum strict profit-orientation is that since granting credit to poor borrowers can turn out to be a profitable business only over the medium or long term, financial entrepreneurs are likely to find other market niches rather than small and micro enterprise lending to be more profitable. This might lead them to give up the target group orientation, which would be desirable from a development-policy standpoint.

Both arguments point to the necessity of an ownership structure which would permit —and indeed ensure— a social service, non-profit orientation. The financial institutions that should emerge should be so. Therefore, the essential question that comes out is: who should be the owners, and what should be the relevant objective of their organisation.
7.1 The Process of Institution Building

Having looked at what the aim of institution building efforts should be, one should look at the process of getting there. There can be many different routes or strategies to choose from. Standard strategies are known by the names of 'downgrading' and 'upgrading'. A downgrading approach is typically pursued with some commercial bank as a partner institution. The restructuring or reorientation of a given institution such as a government owned development bank, or a socially oriented commercial bank is something of a hybrid strategy. Upgrading is an extreme case which creates an entity that can be converted into a target-group oriented bank in due course of time.

7.1.1 Phases of Institution Building

In any case, the process of creating a fully viable financial institution with a clear target-group orientation is difficult and lengthy. It may take up to ten years, and it consists of three phases. During the first or 'childhood' phase, which should not last more than four years, the institution acts as an NGO both de facto and formally. During its first phase, the institution must become a professionally competent lender to the target group. It must have a qualified staff, which becomes familiar with the non-conventional credit technology and with the institution's credit clientele. As the institution builds up its staff and its lending experience, the productivity of its lending operations is likely to grow rapidly. Each loan officer can administer a progressively larger loan portfolio with more clients, and, on average, somewhat larger loans, and overhead costs can be spread over a larger total portfolio for the institution.
After, say four years, the institution should be covering its total costs. At this point, it should be transformed into a formal bank. It is feasible to pass on administrative, risk-covering, and market-determined funding costs to small and micro borrowers. This assumption is derived from the practical experience gained by several NGO-based lending schemes that were studied. The main point is a credit technology, which permits an increase in the productivity of the lending operations. As each loan officer acquires more experience, and the institution as such becomes more established, and the share of repeat business, as opposed to lending to new customers, grows, the individual credit officer can handle many more clients and also somewhat larger loans.

What is the role of donor institutions in this? One could say that the financial institution is like an engine that produces credit efficiently⁴. But the engine can only run if it gets fuel, and in this phase, one important role of the donors is to provide this fuel in the form of funds for on-lending. It is in fact very important that the infusion of funds be extremely well synchronised with the growing capacity of the institution to disburse the funds. Donors must provide sufficient funds, they must provide them on time, and they must be prepared to provide them on favourable terms. During the first year, the required funds should be outright donations; during the second year, they should be soft loans. During the third and fourth years, they should be loans granted at 'normal' interest rates prevailing in the capital market, which after all still entails an implicit subsidy since the institution would normally not have the credit rating required to obtain the funds at 'market rates'. The role of the donors takes in more than just funding. They must also provide technical assistance in the form of
computer and office assistance, and perhaps advisory assistance. Last but certainly not least, donors have to carefully supervise the institution to make sure that it really meets its growth targets.

When financial self-sufficiency is attained, the 'childhood phase' should be followed by the phase of 'adolescence', and the institution should be transformed into a formal financial institution. It should become a bank having the legal form of a corporation. The owners of this corporation should be, first of all, the NGO, which provides its net worth as a financial nucleus for the establishment of the corporation. This net worth is, of course, mainly an outgrowth of the donations, which the NGO has received in the course of the first phase. The donors should also be among the shareholders of the corporation. They should convert their soft loans into equity participation.

The phase of adolescence, which may last for three years, is still characterised by a marked growth in portfolio volume and productivity and a concomitant decline in average lending costs. Funding must continue in the form of straight, normal loans provided by donors in the context of their normal lending activities, and perhaps also by other lenders, e.g. credits obtained on the local financial markets. As a formal bank, the institution should start to accept deposits from its customers. This is more important as an additional service to customers, than as a source of funds. At the end of this phase, the institution should have a loan portfolio large enough to make the bank viable.

Adolescence is followed by a phase of 'early adulthood'. During this third phase, the potential for cost reduction through a combination of portfolio growth
and productivity growth in lending would be exhausted. However, growth could and should still take place, although now it would be largely derived from a combination of pure expansion and some forms of regional and product diversification. Institutions should work towards the improvement of its services, and in particular, for the intensification of its deposit-mobilisation activities, and enhancement of its financial stability.

After a total of ten years, the process of creating a new institution is completed. This institution would be big enough to have strong impact on the relevant regional market for financial services. Most important, there should be an improvement in the quantity and quality of the supply of financial services available to the target group. Small and micro enterprises would then have a reliable source of credit. If, in addition, the example of a successful former NGO which has been turned into a small business bank were to demonstrate to the country’s other financial institutions that lending to small and very small entrepreneurs can be a commercially attractive proposition and give them an incentive to compete for the business of small borrowers, this would be all the better for the target group. At this point, it would be useful to look at the growth of SEWA.

SEWA, an organisation of self-employed women was founded in 1972 as a trade union in the unorganised sector. It evolved from the Textile Labour Association which was itself founded by a woman. Emerging, as it did, at a time when unorganised sector workers, especially women, had little support in the major trade unions or from the state agencies, SEWA’s struggles to survive, to provide the much needed support base for poor women, and laterally to initiate
a process of change among women have today become a model for other similar efforts not only in India, but elsewhere too.

Access to financial services has been crucial for women, especially for the poor. The nationalisation of banks at the macro level changed the ownership of capital at the national level but at the micro level, access and ownership of capital was rare. Although the banks were nationalised, credit did not reach poor women. Drawing lessons, some enterprising women in Gujauat were determined to make capital formation and asset ownership at the grass roots by creating SEWA Cooperative Bank on the one hand as an alternative institutional arrangement, and on the other hand, a web of about 100 cooperatives and 1,000 producers' groups at the grass roots as a broad base. While capital formation was the national Agenda, SEWA's agenda was to ensure it took place in the right places. Building the capacity of women to benefit from, influence. Change, or alter the paradigm of development was a parallel priority. The poor women's capacity to struggle and survive was great, but to participate in the mainstream as an equal was rare. This was gradually realised at SEWA, and capacity building has taken place both at the individual as well as at the organisational level. It has given women access to capacity building mechanisme. They have been offered opportunities to upgrade skills as well as to take advantage of available new technologies, better tools, improved product design, and a chance to export their products.
Chapter 7: A Revised Model: Empowerment from Bottom-Up

BANKING WITH THE NON-BANKABLE

Introduction:

Women workers in the informal sector are economically very active and are mainly involved in production, trading and the service sector. They need finances, for meeting their working capital requirements, for buying land, for repairing or extending house, for buying equipment and other assets. They largely depend on finances from the informal sector like money-lenders, relatives and friends.

Terms of borrowings from money-lenders being very exploitative and there being practical difficulties in availing credit from the formal banking sector, a group of women workers who were involved in trading, processing, other home based business and labour service activities and were members of Self Employed Women’s Association (SEWA) in Ahmedabad, India, decided to form a Co-operative Bank of their own called ‘Shri Mahila Sewa Sahakari Bank Ltd’ in the Year 1974.

Challenges to SEWA Bank at that time in providing banking services to its members were

(i) Non-availability of any collateral or security

Women did not have any collateral or security to offer.
(ii) Non-availability of banking track record

Women did not have any banking track record on the basis of which financial decisions could be made.

(iii) Non-availability of financial information

Since these women did not keep any books of account, or written information, a written financial statement was not available.

(iv) Special kind of operational mechanism

These women being illiterate and their work being labour intensive, they had a different kind of operational mechanism like door to door service, and therefore, needed simple procedures and operational mechanism.

(v) High lending risk

There is a very high lending risk because of the financial vulnerability of the group.

(vi) No blueprint to follow

To meet special types of needs of a different group of people there was no financial services system available or no blueprint was available which could be adopted. Hence, a new system needed to be evolved.
SEWA’s Strategy

Over a period of time (about last 25 years) the following attempts were made to meet these challenges:

(i) **Financial performance used as a collateral**

Since the poor cannot offer any physical asset as collateral and a bank needs some collateral to ensure repayment of loans, SEWA bank used savings performance as well as loan repayment performance as collateral for providing first loan or next loans respectively. Also peer pressure was used as a collateral.

(ii) **Creating women’s own track record**

The bank started motivating and facilitating savings collections, providing loans one after one. This helped women to avail savings and loan facility from the bank on a continuous basis and helped them to create their own financial track record.

(iii) **Designing simple procedures for eliciting information**

Getting required financial information like family income, business income, business expenditure, family expenditure, cost of operations, cost of raw-material, stock of finished goods, by asking simple oral questions. Organizers
and leaders of the banks were trained for collecting required information for assessing repaying capacity, and loan absorption capacity of women.

(iv) **Designing suitable mechanism**

It was necessary to devise suitable operational mechanism as required by illiterate women like, operation of accounts by thumb impression, identification through photographs, door to door collection of savings and loan instalments, simple loan application form, training and extension work. Such operational mechanism was designed over a period of time based on the need of these women.

(v) **High lending risk minimised by establishing linkages**

One of the reasons why poor are vulnerable is that they do not have access to backward and forward linkages and other required support services. SEWA Bank tried to help these women to establish linkages with other support services like training (skill, managerial), marketing, technical support, health care, child care, legal aid, insurance, etc.

(vi) **Establishing continuous contact**

A continuous contact and personal relationship with members on a permanent basis, where they feel this is their own bank and various kinds of their financial needs throughout their life will be met by the bank, has helped women and the bank to build mutual trust and confidence.
These efforts on the part of women as well as on the part of SEWA Bank, enabled women to save, borrow and avail other financial services, which further helped women to create their own capital and assets, to come out of debts, to increase income and productivity and obtain sustainable employment which eventually empowered them and helped them to improve their quality of life. It also helped SEWA bank to become a sustainable financial institution for poor women.

Lessons Learnt

Many years of experience of providing financial services to the poor women, has helped us to learn some lessons.

(i) Poor are bankable

 Majority of poor are economically active and they desperately need financial services. They are ready to save, ready to repay loans, but they need easy access to these financial services. If a suitable mechanism is used they can be financially disciplined group and can be bankable.

(ii) Poor need access to financial services and not subsidies

Poor desperately need capital. They also need other financial services and they are ready to pay for it. In fact, they have been already paying for it to the private money-lenders, but they need easy access to these services.
(iii) Need for suitable operational mechanism

Since majority of poor women are illiterate, their work is labour intensive and they are less mobile, they need a different kind of mechanism, which may be characterised by:

(a) Simple procedures
(b) Oral communication
(c) Help in operations like filling of forms, identification through thumb impression and photographs.
(d) Door to door services
(e) Extension work
(f) Confidentiality of financial transactions

(iv) Need for building mutual trust

Banking business is a risk taking business and its main base is trust. When people are putting their savings in a bank they are trusting the bank and when the bank is giving credit, the bank is trusting the borrower. There is a definite need for creating and maintaining mutual trust and continuous efforts should be made to build this relationship of mutual trust.

(v) Need for adapting holistic approach
An individual needs finances for different purposes, i.e., personal and business, production and consumption. Some of these needs are short term, some are long term and some are urgent. Some can be predicted, some may not be predicted, some can be planned, some cannot be planned. Therefore, an MFI should adopt a holistic approach in providing microfinance services to the poor by having an integrated credit and savings package.

**Diversified Products**

Only loans or only borrowings are not an answer for all these financial needs. Different kinds of financial services and different products within these financial services are needed. These financial services can be broadly divided into three categories, i.e., Savings, Credit, and Insurance. Within these services, each service may be divided into different products, viz.

(i) Savings service may have products like short and medium term savings schemes for marriage or education of children, long-term savings schemes for old age, very short term or current savings for emergencies like sickness, accidents, festivals, pilgrimage, etc.

(ii) Credit service may have products like working capital loans for production cycle period, medium-term equipment purchase loan, long-term housing loan. Within housing loan there may be short-term housing loan for repairing or adding services and long-term housing loan for buying a new house.
(iii) Insurance service may have products like sickness (Health) insurance, accidents insurance, natural disasters like flood, cyclone, fire insurance, man made disasters like riots, war insurance etc. and death insurance.

Combination products for different services, like housing credits linked with housing savings scheme, insurance linked with saving schemes, etc. can also be planned. There is a need for establishing backward-forward linkages such as marketing link, storage, raw-material purchase link, etc. Besides these there is also a need for other support services like health care, child care, housing, training, legal aid, etc. Also required is an enabling policy environment which encourages development of finance activities.

Scope For Savings Mobilisation

The poor, particularly women, have the basic instinct for savings. There is a scope for mobilising savings from these people which has not been tapped so far. If facilitated, huge amount of savings can be mobilised from these women which can be used as a source for financing the poor.

Banking with the Poor can be Sustainable

The poor are ready to contribute and are good repayers of loans if they are served suitably. Suitable mechanism, continued personal relationship, scope for permanent financial relationship, and integrated approach, can help poor people's financial institutions to be financially viable and suitable. Banking with
the poor needs to be considered as a potential banking business and not as a welfare activity.

The poor are economically active and can contribute to the national economy. A very small portion of their financial needs are met by formal financial institutions and a major portion of these needs are met by private traders, money-lenders and relatives. There is a scope for establishing proper banking relations with this segment of the population. They need to be brought to the mainstream of the financial services sector and this can eventually contribute to the economic growth of the country.

7.2 Lessons Learnt

The Indian heritage has its roots in strong community affiliations and identifications, making the social fabric endowed with the spirit of self-help and community help. The society has been throwing up a number of examples of self-help and community initiatives without waiting for external help, as can be seen from the case of SEWA. This is particularly witnessed in moments of crisis and natural calamities. The issue to be looked into, therefore, is how this combination of the spirit of self-help and community service can be harnessed in extending the financial services for the poor. Initial experiences of some of the pioneering NGOs have helped find answers.

The conceptual thinking behind the SHG philosophy and the bank linkage can be summarised as under:

# Self Help supplemented with mutual help can be a powerful vehicle for the poor’s efforts in socio-economic upward migration
Participative financial services management is more efficient and responsive

Poor can save and are bankable

Minimise the mismatch between the expectations of the poor and capabilities of the formal banking system (elaborated in Chapter 5)

Poor need not only credit support but also savings and other services

Small affinity groups of poor, with initial outside support, can effectively manage and supervise microcredit among its members

Collective wisdom of the group and peer pressure is a valuable collateral substitute

SHG is a pre-microenterprise stage for a majority of rural poor

SHG, as a client, facilitates wider outreach, lower transaction cost and much lower risk costs

Empowerment of the poor, and especially women, is a major outcome

7.3 The Indian Experience

The Indian experience of the SHG linkage programme is unique in some aspects. RBI and NABARD have tried to promote "relationship banking" i.e., improving the existing relationship between the poor and bankers with the social intermediation by NGOs. The Indian Model is predominantly a Linkage Model, which draws upon the strengths of various partners-NGOs (who are best in mobilising and capacity building of poor) and bankers (whose strength is financing). Thus, as compared to other countries, where Parallel model of lending to the poor (i.e.' NGOs acting as financial intermediaries) is predominant, the Indian Linkage Banking tries to use the existing formal
financial network to increase the outreach to the poor, while ensuring necessary flexibility of operations for both the bankers and the poor.

The SHG and the Linkage programme are unique in many respects as can be seen from the following:

- A Mechanism: Developing thrift habit among poor, safe keeping of their savings and providing access to funds
- A System: Supplementary to the existing, and not alternative
- A Design: Combining the collective wisdom of the poor, the organisational capabilities of the NGOs and the financial strengths of Banks
- A Business Opportunity: Graduating SHG members as quality microenterprises
- A Framework: Offers opportunity for inter-institutional understanding and cooperation-SHGs-NGOs-Banks
- A Grass Root Institution: Available for social and economic intermediation, focusing on the poor, especially women
- A Process: Leading to empowerment of the poor, and women.

7.4 Linkage Models

The SHG Linkage programme offers a win-win situation for the credit delivery system comprising banks of all types, NGOs and the SHGs as also the poor. Broadly, three different models can be adopted under the Linkage programme:
Chapter 7: A Revised Model: Empowerment from Bottom-Up

SHG-Bank Linkage Model-I
(NGOs as SHPls)

NGOs → Promotion, Training & Helping → SHGs
in linkage with banks

Banks

SHG-Bank Linkage Model-II
(NGOs as Financial Intermediaries)

NGOs → Promotion, Training & Providing → SHGs
Credit support

Banks

SHG-Bank Linkage Model-III
(Banks as SHPls)

Banks → Promotion, Training & Providing → SHGs
Credit support

Each of these models should be qualitatively assessed to arrive at the strategic significance and scope for widespread adoption. Criteria for evaluation may include factors like:

- transaction cost of lending for the banks
- transaction cost of borrowing for the SHGs and the poor
- risk of funds and guarantee of repayment
- load of coordination and management
- ease of adoption by all stakeholders
- smoothness and ease of providing credit to the poor and its repayment
- quick replicability
- social and economic impact of SHG movement
• extent of social investment required

Using these parameters, the advantages and limitations of the three models are presented below:

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Limitations</th>
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<tbody>
<tr>
<td><strong>Model I</strong></td>
<td><strong>Model I</strong></td>
</tr>
<tr>
<td>1. Each partner institution plays a role best suited to it. Banks lend, NGOs organise poor into SHGs, and SHGs manage small group finance in their own interest.</td>
<td>1. In spite of wider acceptability of the model, majority of field level bankers are yet to be sensitised do not view it as banking mandate.</td>
</tr>
<tr>
<td>2. The whole system is localised</td>
<td>2. In many places, it is still difficult to open a savings account</td>
</tr>
<tr>
<td>3. SHGs and local NGOs learn to deal with an accessible bank branch and vice-versa.</td>
<td>3. Absence of NGOs in many areas</td>
</tr>
</tbody>
</table>

**Model II**

| 1. It further reduces the transaction cost and risk cost of the bank as the banks lend a larger sum to the NGO, Which guarantees repayment | 1. NGOs are not traditionally equipped to work as financial intermediaries |
| 2. Easier for poor to deal with an institution which they know and trust | 2. Calls for substantial investment in capacity building of NGO |
| 3. Easy to be adopted by all the stakeholders | 3. Adds one more intermediary structure |
| 4. Wide scale of adoption not possible | 4. Wide scale application may not be feasible because of other priorities of bankers. |

From the experience gained, it is observed that the Linkage Programme has brought into focus some of the striking new approaches being followed by the SHGs and the banks, which could be considered as best practices contributing to their continued healthy growth in the rural areas of the country. One such example of the Gurgaon Gramin Bank has been taken up in Chapter 4. Some more are discussed below:
At the Group Level

- Homogeneity and affinity among members
- Regularity in savings
- Regularity in Group Meetings
- Collective decisions
- Loan availability at doorstep without hassle
- Not influenced by subsidy syndrome
- Social engineering
- Building of common fund as main bondage among members

At the Bank Level

- Dealing with groups instead of individuals-outreach
- Externalisation of loan functions to groups-functional efficiency
- Reduction in cost of transactions-both in credit and savings operations
- Non-subsidy orientation-sustainability
- Positive attitudinal change in dealing with the rural poor-confidence building and acceptability
- Finding social banking profitable-100% repayment

At the NGO Level

- Add-on activity leading to deepening of their intervention
- Concept brings in cost-effectiveness in delivery of services
- Opens up possibilities of financial intermediation
- Recognition from the formal banking system
- Cementing factor for core developmental functions
7.5 Limitations of the Approach:

7.5.1 Absence of Partner NGOs

The growth of the linkage programme is dependent on the initiatives and efforts of the partners. Non-availability of NGOs can come in the way of the progress of the programme. Furthermore, NGOs need to have a properly trained workforce to take up ground related savings and credit management activities on a large scale. This is time-consuming. In the absence of any organised training system for the field staff of NGOs in savings and credit management, such training has to be received from some other experienced NGOs, who may have limitations of capacities.

7.5.2 Sensitisation of Bank Staff

Large scale upgrading would call for awareness building, sensitisation and reorienting the staff of the banks in appreciating the differences in the SHG approach as compared to the traditional approach. Although the banks have initiated steps in this direction, a lot more may have to be done, keeping in view the regional potentials, availability of experienced NGOs, periodic changes at field level, etc.
7.5.3 Target Syndrome

With the progress of the programme and the encouraging results, expectations get aroused. The government departments and other agencies may try to implement several income generating programmes through the medium of SHGs. This leads to a lurking fear of the targets compromising with the quality of the groups and creating new sets of defaulters. Conceptually, the spirit of Self Help and the dependence on external financial sources do not go hand-in-hand. Excessive exposure to such incentives could lead to disintegration of the groups.

7.5.4 Slow Process

The SHG linkage programme per se is not a poverty alleviation programme. It is basically a graduation process for socio-economic empowerment of the hard core poor, especially women, providing financial services to them and preparing them to take up activities and bank credit for poverty alleviation. It is a slow, countervailing process requiring time, efforts and training on the part of linkage partners and cannot be treated as a panacea for all socio-economic problems like unemployment, poverty, and empowerment of women.

7.6 Upgrading of SHG Linkage Programme

The progress so far has validated the conceptual frame, the operational feasibility, acceptance among the partners including the poor, especially
women, and has been recognised as one of the potent microcredit delivery mechanisms.

With proactive measures taken up by all partners over the last decade and with the active support of the RBI, the SHG Linkage programme is in the process of gaining acceptability across India. All the partners in the linkage programme will have to play a more active role in the next few years in transforming it into a movement. Thanks to the now established virtues of the SHG Linkage programme, a number of State Governments (more particularly, in Andhra Pradesh, Kerala and Tamil Nadu) have initiated measures to adopt the SHG concept in reaching the rural poor through various credit programmes.

The SHG Linkage programme has come to stay as a strong supplementary credit delivery mechanism in India. Recognising this, the RBI has advised the banks to treat SHG financing as a mainstream credit activity under priority sector and service area approach. Banks have also realised the potential of Linkage Banking with lower transaction costs and excellent repayment of loan portfolio. Needless to mention, the “Tri Mantra” of any rural banker would be to look for (i) deposit mobilisation; (ii) increase in credit flow; and more importantly (iii) very good repayment/recovery of loans issued. The SHG linkage programme has the potential to offer all the three components and it could be rechristened as a “Three-in-One Programme” for a banker⁸. It has also disproved the myth that social banking means a losing proposition.

However, it must be recognised that SHG Linkage programme is not a panacea for the problems of poverty and empowerment. At the same time, it has all the
potential for becoming a permanent system of lending to the economically and socially downtrodden in the country. It can, in due course of time, with full participation from the formal banking system, and without any interference from the government, be one of the major programmes to bring about economic empowerment.

References:


5. SEWA (1999), "SEWA: The Self Employed Women’s Association of India", Website.


The high incidence of poverty is the bane of the Indian economy. The alleviation of poverty, which continues to be the greatest challenge facing the government, has been the central objective of India’s development planning and policies. Several socio-economic programmes have been pressed into operation by government and non-government organisations, adopting varied approaches to attack poverty. It has been recognised that poverty can be reduced most effectively through a strategy with two equally important and mutually reinforcing elements\(^1\). The first element is to promote productive use of the most abundant asset of the poor, i.e. their labour, through infrastructure development and income generating activities. The second is to provide basic social services to the poor in terms of health, education, nutrition and family planning. Banks and financial institutions in the country have focused on the first element and tried to reach the poor through provision of small credit for self-employment ventures at concessional rates.

However, imperfect market information, particularly about rural credit markets, and imperfect enforcement of contracts leading to high probability of loan default, has made lending mostly collateral-based. As a result, the poor and the women with scarce physical assets have been left out of the formal credit system.
8.1 The Issue of Economic Empowerment of Women

A major shortcoming of the credit system has been its apathy towards the issue of empowerment of women\(^2\). Economic strength is considered the basis of social, political and psychological power in any society. Many a times, the low status of women stems from their low economic status and their consequent dependence on men. Their powerlessness and lack of decision making power is derived form a combination of the following factors:

(1) Women not being allowed to acquire education and higher waged skills due to gender discrimination.

(2) Restriction of women to low-skill-low-pay jobs.

(3) Women’s lack of access to training, credit and business.

(4) Women’s work and contribution to family and economy being invisible and unpaid.

(5) Majority of women being in the unorganised sector of the economy.

(6) Restricted mobility of women.

(7) Women’s capacity and ability to manage money being unrecognised.

(8) Lack of opportunities for women to express their abilities and leadership qualities.

Thus, because women’s economic position is weak both within and outside the family, women are viewed more as liabilities than as assets. They are unable to assert and demand a just share in either the household or the society resources. But the truth is that women are a powerful force that can be empowered to the benefit of not just their families, but also the society and the nation to which they belong.
Therefore, what is needed is a banking programme for women that provides them economic strength. This will enable women to gain both visibility and a voice in their homes, their workplace and their society. As women become major economic contributors or equal to men in economic terms, their families, and society at large changes its attitude towards them. This empowerment benefits the women and their families, helping in the fulfillment of the national objectives of social and economic upgradation of the poor.

8.2 The Promise of Microfinance

Microfinance refers to making available financial services, consisting mainly of credit and savings, in a manner, which is profitable both for the financial institutions and for the customers, who do not have access to such services currently\textsuperscript{3}. Thus, microfinance definitely covers poor women, and is a potent tool to achieve their economic empowerment. It is commonly understood to refer to programmes meant for providing credit for self-employment and other financial and business services (including savings and technical assistance) to very poor and needy persons.

Microfinance should help poor women in three ways:

- First, by providing independent sources of income outside home, it tends to reduce economic dependency of these women on husbands, and thus helps enhance autonomy.
- Second, the same independent sources of income together with their exposure to new sets of ideas, values and social support should make these women more assertive of their rights.
• And finally, these programmes, by providing control over material resources, should raise women's prestige and status in the eyes of husbands and societies.

Microfinance is unusual in being a poverty-reducing institution which "pays for itself". It has now spread successfully to most developing and a number of industrialised countries⁴. On the evidence of the assessments so far published (Chapter 2), the following features appear to be particularly strongly associated with its success (in terms of both profitability and poverty reduction potential): cost-covering interest rates, incentives to staff and borrowers, the existence of savings and insurance facilities, and above all, intensive loan collection facilities which minimise the borrowers transaction costs.

8.3 The Experience of Indian Banks

The banks in India have disbursed a massive volume of credit to the poor. Notwithstanding the proactive role of banks (through their extensive network) in implementing government sponsored poverty alleviation programmes such as IRDP, the economic enablement through capital transfer and application has not gathered the desired momentum. The Indian banking industry has been plagued with low returns on microcredit operations, coupled with the high cost of microfinance services and has become apprehensive in providing the much needed impetus to this socially and financially important sector. The banks in India have shown remarkable resilience and have many innovations to their credit. Barring the last few years, they have worked in a regulated interest rate regime and mandated target lending. Thus, the banks have traversed through
the security-oriented individual banking to subsidy-oriented individual banking. However, a large volume of mandatory lending has piled up unmanageable non-performing assets, and has affected the viability of the banks. This has prompted a search for a viable and sustainable means of purveying credit to the poor, especially the poor women.

8.4 **New Experiments in Microfinance**

However, contrary to the experience of the past in the field of subsidised credit under government sponsored programmes, the new experiments in microfinance (Chapter 4) are able to demonstrate that it is possible for financial institutions to provide financial services to the poor, and to poor women in a sustainable manner. In India, in recent times, new types of microfinance institutions are being launched. They concentrate exclusively in the field of microfinance and adopt products, policies and procedures which can enable them to deliver these services in a profitable manner. The banks have a larger canvas, and microfinance is one of their many activities. The MFIs adopt diverse methodologies in reaching the poor. Chapter 4 studies one such exemplar-Gurgaon Gramin Bank, which has devised a successful model of extending microcredit support to poor women in four districts of Haryana. The vastness of our country, and the magnitude of social and economic problems necessitate that we learn lessons from these successful experiences, and try to transform them into larger and wider success stories.

The Indian banking industry has played an important role in improving the outreach of financial services to the poor. It should continue to be the
forerunner in the field of microfinance by virtue of its vast network of branches and trained manpower. But the banking system will have to reinvent itself in many ways for playing the expected role in the area of microfinance that has potential business opportunities. The banks would need to change their attitudes towards the poor, innovate new lending and saving products, and forge strategic alliances with NGOs and MFIs.

8.4.1 Problems of formal banking sector

In serving the poor, the formal banking system has the following shortcomings:

8.4.1.1 Rigidity and lack of innovation: The formal banking sector is overly bureaucratic. Rules and regulations are the norm, while new ideas and the enthusiasm to carry them through to implementation are the exception. The formal sector will not be successful in meeting the demands of the informal sector if it is unwilling to acknowledge this fact and adapt itself accordingly.

8.4.1.2 Office oriented work approach: In the formal banking sector, everyone is accustomed to sitting behind a desk. Providing financial services to the poor requires the minimisation of paperwork and spending more time with clients in the field.

8.4.1.3 Collateral: A quality service caters to a client’s needs and desires. Insistence on collateral is an obvious hurdle between the poor (by definition, without much capacity to provide collateral) and the services provided by the formal sector.

8.4.1.4 Delayed decision making: With so many loans for so little profit, banks cannot afford to spend time or money in delaying decisions related to approval of microcredit applications.
8.4.1.5 Job permanency: Someone having a guaranteed job security does not have the motivation to put in extra efforts. A formal bank will face problems in handling the informal markets if their workforce is not motivated.

8.4.1.6 Unable to work in the situational context: Work in the informal markets requires adaptability to local environment, but many times, the staff lack either the capacity or the willingness to do so.

8.4.1.7 Rigid interest rates: The formal sector cannot be expected to operate at a loss. This would not be in the interest of a long term informal banking solution to the demand of the poor for financial services. Interest rates are far too rigid, and are a drag on the development of the informal sector.

8.4.1.8 Trained to work in a formal setting: The formal sector trains with formal sector objectives in mind. These are inadequate and inappropriate for serving the needs of the informal sector.

8.4.2 Prospects of formal banking sector

However, the same formal banking system also has some strengths. These are as follows:

8.4.2.1 Resource availability through mobilisation: Saving services are in high demand among the poor. This demand, if tapped properly, could provide the formal banking sector with a significant source of capital.

8.4.2.2 Confidence of the people: Formal banks are much better known than their MFI counterparts and therefore, enjoy the confidence of the people. Banks should capitalise on this in order to play in financial services delivery to the informal sector.
8.4.2.3 Qualified staff: The level of expertise of formal bank staff gives it a distinct advantage in the quest to provide efficient financial services to the poor.

8.4.2.4 Working in the legal framework environment: Formal banks work within the legal framework set up by the government and the banking sector. Therefore, they can contribute a great deal making sure an appropriate policy framework is established as their expertise in the informal markets grows.

8.5 Whither Attack on Poverty?

Chapter 5 takes a look at the programmes that have been designed for a direct attack on poverty, with a view to achieving growth with redistributive justice. Under these programmes, it is expected that the poor would be identified based on a set of well-defined criteria. In the process, the host of programmes came up with the objective of attacking poverty by bringing improvement in the economic conditions of the poor. Drought Prone Areas Programme (DPAP), National Rural Employment Programme (NREP), Programmes under Small Farmers Development Agencies (SFDA), and Marginal Farmers and Agricultural labourers Agencies (MFAL), Crash Scheme for Rural Employment (CRSE), Food for Work Proframme (FWP), Rural Landless Employment Guarantee Programme (RLEGP) down to Jawahar Rozgar Yojana (JRY)\(^6\) - all were intended to directly target different segment of the poor. Although IRDP, in terms of its coverage, can be easily recognised as the largest anti-poverty programme anywhere in the world, it has been brought out that a substantial amount disbursed under it has either not reached the target groups, or even when it has reached them, has not been able to show the desired results. The study conducted in this research to test the hypothesis if economic status is
judiciously ascertained before any microcredit help is extended reveals that this is not the case. In other words, the poor impact of these programmes can be attributed to the fact that the real beneficiaries of the programme are not the really poor people. Moreover, the poor are not involved either in the designing or in the implementation of the programmes.

8.6 Social Intermediation before Financial Intermediation

Therefore, as shown in Chapter 4, and as also gathered from the published literature, social intermediation must precede any form of financial intermediation\(^7\). It was revealed that any process of economic empowerment, whether of poor women in particular, or the poor in general, begins with social intermediation. Social intermediation is a process in which investment is made in the building of both human resources and institutional capital with the aim of increasing the self reliance of marginalised groups and preparing them to engage in formal financial intermediation (Bennett Lynn, 1997). NGOs are more suited to building social capital in the form of groups that can generate a sound base for their members to develop their credibility as borrowers and encourage financial institutions to develop confidence in establishing a lending relationship with the groups. Thus, NGOs can transform the ‘beneficiaries’ into ‘borrowers’ leading to establishment of system and structures in which a sustainable process of linking the poor borrowers to sources of capital and other financial services with formal financial institutions is achieved.

It is definitely feasible for staff of rural bank branches also to take up social intermediation and form SHGs. However, it is essential that the branch staff be
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convinced about the efficacy of SHG for socio-economic empowerment of the poor. It is also necessary that the entire branch staff, including the sub-staff, be involved in the SHG activity. Capacity building and attitudinal change of the entire branch staff regarding SHGs is also important. This will also help in nurturing and monitoring of the SHGs.

8.6.1 NGOs as Social Engineers

It has been observed that there is a phenomenal decrease in the efforts and cost of group formation of SHGs for the second and subsequent groups in the village. Therefore, while NGOs are indispensable in being pioneers in the task of social intermediation by forming and nurturing SHGs, the rural bank branches can take up the task on themselves with almost an equal degree of competence. Banks can then also extend their role to financial intermediation.

The mainstream banking institutions in India should consider providing access to credit to the poor and poor women. This can be done by collaborating with NGOs, and even MFIs, who can make the task easier for the commercial banks. The necessary onlending funds need to be made available to the NGOs/MFIs after being convinced about their credibility. The role of the commercial banks would be appropriate when they cater to supporting and thereby encouraging NGOs/MFIs in their efforts to reach out to the poor and poor women.

Chapter 6 discusses how NGOs have certain inherent advantages while forming and nurturing SHGs. These advantages stem from their proximity, both
physically and emotionally, to the poor people. However, if more people have to be covered under microcredit, then more SHGs must come up, and their formation cannot be left entirely to NGOs. Other agencies, particularly the RRBs must be involved in this task.

8.7 Time for some Grass-root Initiatives

Chapter 7 discusses the feasibility of alternative approaches to the financing of persons of small means by promoting organisations based on grass-root initiatives. On the other hand, under the government-sponsored programmes, people normally see the government as the "provider". This perception makes them passive and stifles their potential strength to organise themselves for a common cause, viz., ameliorating their own economic conditions through mobilisation and pooling of their small means and using such means according to their own best judgement. The direct involvement of the government in the formulation and implementation of the government-sponsored programmes for the poor has discouraged alternative approaches based on grass-root level initiatives. Experiments in South Asian countries such as Bangladesh and Sri Lanka have proved beyond doubt that the poor can be socially and economically mobilised and through such mobilisation, they can be enthused to form institutions which are "organisations of the people, by the people and for the people" to address their basic economic and social needs. Thus, any kind of empowerment must begin at the bottom and move upwards.
Microfinance is not a new activity for our country. India is perhaps one of the few developing nations which has strategically promoted institutions for providing financial services to the poor, and the poor women. The cooperative institutions, with a glorious history of 100 years, and the regional rural banks, established in mid-1970s, are essentially microfinance institutions. They provided credit along with the rural branches of commercial banks to the poor through several schemes under the directions of the government. The culmination of all such schemes is the IRDP, the single largest poverty eradication programmes of the country, which has provided assistance to the extent of Rs. 250 billion to more than 50 million rural poor since 1980.

Despite the fact that a large network of banking infrastructure provides microfinance services to the poor in a big way, Indian initiatives have not been recognised as successful intermediation for banking with the poor, more so the poor women. This is on account of a host of factors such as weak policy environment associated with directed lending rate not covering costs, weak capital base, unrealistic targeting, vitiated climate of financial discipline leading to the culture of non-repayment, high borrower transaction costs, weak enforcement of legal contracts, unrealistic product design which did not fully suit the requirements of clients, and absence of an incentive structure.

Some observers of Indian rural financial system have been very critical of its functioning. They have, however, not captured the strengths of the Indian rural financial system. While there is no doubt that the system is plagued with the
above stated weaknesses, it is also true that India could have been one of the best possible models for providing effective financial services to the poor, if only the policy environment could be more conducive. In the absence of any conducive policy environment, Indian banks have really been participating in the poverty alleviation credit programmes out of compulsion, rather than as a business choice, or a mandate. In view of this, it is natural that their qualitative performance in the field is far below the desired level.

References:


