Chapter – 2

REVIEW OF LITERATURE
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This section provides a review of some of the important theoretical and empirical works done in the field of Micro-finance and SHGs and their linkage. This includes conceptual issues concerning Microfinance and SHGs, as well as, the reach and importance of the linkage programmes.

2.1 History of Microfinance

The concept of microfinance can be traced back to proportions of the Marshall Plan at the end of World War-II and the writings of legal theorist Lysander Spooner in 1880s. Spooner wrote concerning the benefits of numerous small loans for entrepreneurial activities to the poor as a way to alleviate poverty. However in its most recent incarnation, it can be linked to several organizations starting in the 1970s and onwards. In developing countries, Dr. Akhter Hameed Khan as the founder of East Pakistan (new Bangladesh) Academy for Rural Development introduced the idea of microcredit (microfinance) in 1959. His Comilla Cooperation Pilot Project is considered as an early example of microcredit and rural development initiatives in developing countries. In the 1980s Khan founded Carangi Pilot Project in slums of Karachi, (Pakistan). In 1971, Al Whittaker established Opportunity International’s first US office in Washington DC. About the same time Australian philanthropist, David Bussan, began offering micro loans in Indonesia. The two men met and formed Opportunity International which provides opportunity for people in chronic
poverty to transform their lives by creating jobs, stimulating small business and strengthening communities.

In 1973 ACCION International, a Peace Corps like groups, started to switch their focus towards providing economic opportunity to poor people. ACCION offered an alternative to the underserved population that were ineligible for traditional loans and wanted to avoid the exploitive lending practices of loan sharks. Within four years the experiment had shown its success in having provided 885 loans with a repayment rate of over 90 percent. ACCION claims that these loans were the first modern pioneers of microcredit.

Around the same time as ACCION’S experiment and apparently independently, Muhammad Yunus, a professor of Economics at Chittagong University started a similar experiment. Around 1974, during a famine in his native Bangladesh, Yunus discovered that very small loans could make a difference in a poor person’s ability to survive, but that traditional banks were not interested in making tiny loans to poor people, who were considered repayment risks. In 1976, Yunus founded the Grameen Bank to make loans to poor Bangladeshis. Since then the Grameen Bank has issued more than $ 5 billion in loans to several million borrowers- at the close of 2005 the number of outstanding loans is more than 4 million.

The success of the Grameen model has inspired similar efforts throughout the developing world and even in industrialized nations including the United States. SKS Microfinance was founded in 1998 by Vikram Akula to provide loans to women living in poor regions of India. In May 2006, Vikram Akula was named to TIME Magazine’s Top 100 List of Most Influential people for the year 2006, wherein he was highlighted for his work as a pioneer in the microfinance industry and dedication to improve to lives of the poor in India. (http: // en. wikipedia.org / wiki / Microcred.)
In 1988, NABARD took up the initiative for a policy framework of alternative credit delivery to the poor through Self Help Groups. In 1991, RBI issued a circular to the commercial banks informing the launching of the pilot project establishing linkage of SHGs with banking structure of the nation. According to Nair (2005) the organizations like Mysor Rehabilitation and Development Agency (MYRADA), Shantidhan, Rural Development Trust (RTD) etc., have been providing credit and thrift services to the poor since 80's.

2.2 Definition of Microfinance

The definition of microfinance extends its purview from the simple arrangement of finance for the poorer section of society in different areas to the different fields of activities in different forms. According to Robinson (1998), microfinance refers to "small-scale financial services for both-credits and deposits that are provided to people who farm or fish or herd; operate small or micro enterprises where goods are produced, recycled, repaired or traded; provide services; work for wages for commissions; gain income from renting out small amount of land, vehicles, draft animals or machinery and tools; and to other individuals and local groups in developing countries, in both rural and urban areas".

The Asian Development Bank (2000) defines microfinance as the provision of financial services such as deposits, loans, payments services, money transfer and insurance to poor and low income households and their micro-enterprises. Microfinance services are provided by three types of sources: formal institutions, such as rural banks and cooperatives, semiformal institutions such as Non-Government Organisations (NGOs) and informal sources such as money lenders and shopkeepers. Institutional microfinance is defined to include microfinance services provided by both formal and semiformal institutions.
In India, the Task Force on supporting and Regulatory Framework for Microfinance constituted by the Reserve Bank of India (RBI) (1999) has defined microfinance as the provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas enabling them to raise their income levels and improve living standards (NABARD, 2000).

Although both, the term microfinance and micro credit is often used interchangeably, the meaning of the term micro credit is much narrow in scope referring more specifically to the credit aspect of microfinance. Microfinance is much more holistic than micro credit as it includes savings, credit, insurance etc. Currently, much emphasis is given on the credit aspect, thus micro credit is the buzzword.

Yunus (2003) states that Micro credit means more emphasis on loans while microfinance also includes support services where channels for thrift, market assistance, technical assistance, capacity building, insurance, social and cultural programmes are opened. So, where microfinance is ‘credit plus’, there microcredit is only credit.

A broad classification of micro credit is provided by the pioneer Yunus (2003), which he says is not the end in itself. These are as follows –

1. Traditional informal micro credit (such as, moneylender’s credit, pawn shops, loans from friends and relatives, consumer credit in informal market, etc.);
2. Micro credit based on traditional informal groups (such as, tontin, su su, ROSCA, etc.);
3. Activity based micro credit through conventional or specialised banks such as agricultural credit, livestock credit, fisheries, etc.);
4. Rural credit through specialised banks;
5. Cooperative micro credit (cooperative credit, credit union, savings and loan associations, savings banks, etc.);
6. Consumer micro credit.;
7. Bank-NGO partnership based micro credit.;
8. Grameen type micro credit or Grameen credit.
9. Other types of NGO micro credit.
10. Other types of non NGO non-collateralized micro credit.

According P Satish (2005), microcredit refers to loans to poor households in rural and urban areas for income generation through self-employment. Micro credit is usually associated with very small loans, no collateral, borrowers from among the rural and urban poor, and loans for income generation through market-based self employment, and the formation of borrower groups.

2.3 Different Approaches to M.F. Programme

There are numerous micro credit / microfinance programmes around the world that follow different approaches and philosophy. Christen and Drake (2002) point out that there exist two different approaches in the evolution of the Micro Finance industry –

(i) Latin American Model popularly known as commercial model that focuses on enterprise creation and growth.

(ii) The south Asian Model that focuses on women and poverty. First approach is founded by non SHG linkage methodology, while second one is basically undertaken by SHGs and other groups (T.S. Nair 2005). F Sinha, (2005) observed that as far as the dispensation modes of micro financing is concerned, these are 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. The dominant microfinance dispensation models in India are –

(a) An Intermediate Model that works on banking principles with focus on both savings and credit activities and where banking services are provided to the clients either directly or through SHGs.

(b) There is also a wholesale Banking Model where the clients comprise NGOs, MFPIs and SHG Federations. This model involves a unique package of providing both loans and capacity building support to its partners; and

(c) Further, there is an Individual Banking based Model that has its clients as individuals or joint liability groups. While programme management and client appraisal in this Model may be a challenge, it is best suited to lending to enterprises (www.nabard.org). Among the following five models the first three are popularized by NABARD and others by big micro-financing institutions (MFIs).

**Model I**: Banks promote SHGs and finance them directly.

**Model II**: NGOs facilitate the promotion of SHGs and Banks finance SHGs.

**Model III**: NGOs borrow funds from Banks/FIs and provide services to SHGs/Clients (ASA, BSS, G. Koota).

**Model IV**: NBFCs\(^1\) mobilise Equity and loan funds from Banks/FI (Financial Institutions) and provide services to SHGs/Clients (SHARE Microfinance Ltd, Asmitha, BASIX etc.).

**Model V**: Registered Co-operatives (SEWA\(^2\) Bank).

\(^1\) Non Bank Financial Companies

\(^2\) Self Employed Women Association
According to P. Satish (2005), the Micro finance methodology could be classified into five groups. It is given in the following way –

1. Grameen and solidarity model: Grameen bank in Bangladesh, Bancosol in Bolivia, Solidarity groups in Latin America. 3-8 persons, each active and assuming responsibility, lending and repayment to and from members through guarantee of the groups members.

2. The Group Approach: SHGs Bank linkages in India, Chikola groups in Kenya. It delegates entire financial process (saving, loans, and repayments) to the group which besides using their own fund also mobilises and secures additional finances from financial institutions, MFIs.

3. Individual Banking: BRI- Unit Desa in Indonesia, Small Credit given to individuals based on appraisal, disbursement savings and repayments.

4. Community Banking: Priority sector lending by banks in India especially by Regional Rural Banks (RRBs) and Cooperative Banks. Expanded group approach of 35-50 members; borrow finance from the programme implementing agencies and on lend to numbers.

5. Credit Unions and Co operatives: Village Bank of FINCA in Latin America replicated in Africa and Central Asia., Member owned organizations providing credit and other financial services. Apex bodies provide technical and financial service.

In the Indian context, study undertaken by Frances Sinha (2005) points out difference approaches of microfinance delivery viz. i) Self Help Group Model and (ii)Grameen Replication Model. A small number of microfinance institutions (MFIs) also follow the individual working approach, the study states.
2.4 Group Lending Approach to Microfinance

Stiglitz (1990) in his analysis found that peer monitoring and the delegation of monitoring activities to members in group lending programme reduces moral hazard behaviour of individual group members and helps in reducing the costs of lending, which may be translated into lower interest rates for the borrowers.

Similarly, Hoff and Stiglitz (1990) have shown how the lending of the banks to the groups, create a joint liability for the bank loan among the members of the group and thereby shifts the responsibility of selection, monitoring and enforcement of repayment from the bank to the group.

There are several advantages of group lending setup. according to Anderson and Nina (1998), rather than a bank, borrowers themselves undertake the task of credit evaluation; this creates a peer screening effect and reduces the transaction cost as community members have much better information than banks.

Umdor (2006) in his study states that the approach in group lending is that instead of lending directly to individual borrowers, banks lend to group of borrowers and the group in turn lends to the individual members. In this way all the members of the group are jointly liable for the loan. Economists have attributed the success of this approach to peer monitoring, group pressure and social ties, which has enabled microfinance programme to mitigate problems associated with micro credit such as lack of collateral, high screening and monitoring cost, lack of information in accessing loan proposal and on borrowers as well as high default rates. Also, the joint liability in group lending replaces the collateral requirements associated with banks loans with social collateral.

Dr. A.P.Pati (2006) in his study opines that the desire to preserve valuable social ties induces borrowers to spend extra effort if necessary to secure timely payments.
Social ties are valuable because they allow members to borrow in the future and provide business connections. Moreover a very important feature of group lending is the collateral effect. What primarily distinguishes microfinance from the traditional provision of financial services is the absence of collateral as security for a loan. Instead money is advanced on the basis of reputation.

2.5 Institutions / Organisations Implementing Micro Finance Activities

Sriram and Upadhyayula (2004) in their studies try to give an analysis of the relationship between NGOs and microfinance. According to them, NGOs in India perform a range of developmental activities; microfinance usually is a sub component of some of these. NGOs organise groups and link them to an existing provider of financial services. Here we refer to the case of these organisations which are not directly involved in microfinance activities. In some cases NGOs have a “revolving fund” that is used for lending. But in either of these cases, microfinance is not a core activity for these NGOs. An example is the Aga Khan Rural Support Programme India (AKRSP-I). For AKRSP-I, the microfinance component is incidental to its work in natural resource management. Sriram and Upadhyayula also state about those NGOs helping the poor in economic activities. Their purpose is developmental. They see microfinance as an activity that feeds into economic activities. It then arrange for loans to its members through banks. When the arrangements are not effective, it started providing loans itself.

At the third level, we have organisations with microfinance at the core. They have developmental roots, but are diverse in their operational details, orientation and form of incorporation.
Resource organizations that provide support to implementing organisations in terms of resources or training for capacity building counseling, networking etc. may operate at state / regional or national level.

Formal financial institutions include commercial Banks, Rural Banks and Cooperatives Banks that provide funds to SHGs and also operate their accounts. Development agencies like NABARD, Small Industries Development Bank of India (SIDBI) and Rastiya Mahila Kosh (RMK) provide funds for credit. They support MFIs and have separate allocations for SHGs and micro-credit. Commercial banks as well as co-operative banks are also actively participating in the SHG Bank Linkage Programme.

Dr. A.P. Pati (2006) in his study states that organisational interventions for microfinance can come through four broad categories of suppliers of finance. They are (i) National level financial institutions, basically engaged in refinancing activities, (ii) Banking institutions; (iii) Government channels through different developmental programmes (iv)Other donor agencies in both public and private domain including NGOs. In most of the cases, these organisations provide finance to an intermediary engaged in microfinance activities popularly known as Micro Finance Institution (MFI). These MFIs either supply finance to SHGs as group or to individual borrowers. Besides these formal and semiformal sources, informal sources like money lenders and shopkeepers also supplement the microfinance.

2.6 Recent Developments in India

Namboodiri and Shivani (2001) traced the development of the microfinance programme in India through SHGs model. According to them the SHGs system was initiated in India by the initiatives of NGOs. In 1991, National Bank for Agriculture and Rural Development (NABARD) initiated a programme to finance 500 SHGs
through schedule commercial Banks in 1991. The result of this pilot project led to the constitution of a working Group by the RBI that recommended including lending to SHGs under priority sector advances and integrated with main stream credit operation. Today, the NABARD initiated SHG bank linkage programme has emerged as one of the largest microfinance programme in the world.

Sinha and Patole (2002), state that in India besides the SHG bank linkage programme, there are other two approaches to provide financial services to the poor by the MFIs, namely the co-operatives and the Grameen replica. In the co-operative approach, the most successful cooperatives societies are the Self Employed Women Association or SEWA Bank in Ahmedabad, the Indian Co-operative Network for Women in Tamil Nadu and the Annapurna Mahila Co-operative Credit Society in Mumbai. Another approach is the replica of Grameen model, where a MFI lends to the individual who belongs to a joint liability group within which peer pressure is the key factor in ensuring repayment.

Microfinance in India started in the early 1980s with small efforts at forming informal SHGs to provide access to much needed savings and credit services. From this small beginning the microfinance sector has grown significantly. Sriram (2004) points out that national bodies like the Small Industries Development Bank of India (SIDBI) and the NABARD are devoting significant time and financial resources to microfinance in India.

Dasgupta (2005) in his review of the microfinance programme in India compares the programme of the microfinance of the two main microfinance programme in India, the Swarnajayanti Gram Swarozgar Yojana (SGSY) scheme and the SHG bank linkage programme (SBLP). He found that while the SGSY scheme has been more successful in poorer states like Bihar and Madhya Pradesh, the SBLP continues

to be southern states centric, with the southern region accounting for 63 percent of SHGs credit linked and 79 percent of credit disbursed till 2004.

Some studies have been done on the socio-economic impact of SBLP in India. Chen and Snodgrass (1999) evaluate the impact of credit and saving programme of SEWA Bank in city of Ahmedabad in Gujrat, in India. The impact study is based on the baseline data and uses the quasi experimental methodology to compare the two groups of borrowers and savers (the latter being the members of SEWA who did not have loan outstanding) with non members of SEWA. When compared, the study has found that the clients of SEWA had more income, better homes and more sources of income tan non members. However, within the members of SEWA, the borrowers fared much better than the savers. The study shows that average income of borrowers and savers households was 39 percent and 12 percent higher than non member household.

Another study by Chen and Snodgrass (2000) also finds that women who participated more extensively in a range of SEWA activities benefit more extensively.

The other study under taken by Puhazhendi and Satyasai (2000) find a positive impact often programme on the members in terms of increase in income and assets, consumption expenditure, improved saving habits, better access to credit and increase use of loans for productive purposes. This study covers 11 states namely Rajasthan, Orissa, West Bengal, Uttar Pradesh, Madhya Pradesh, Gujarat, Maharastra, Andhra Pradesh, Karnataka, Kerala and Tamilnadu.

Another study undertaken by Puhazhendi and Badatya (2002) on the economic and social impact ofthe SBLP covering Orissa, Jarkhand and Chatisgarh reported a positive impact on employment and poverty.
Murthy, Raju and Kamath (2003) evaluate the impact of South Asia Poverty Alleviation Programme (SAPAP), a microfinance based intervention on women’s empowerment and poverty reduction in 3 districts of Andhra Pradesh. The study reports that members of SHGs have better and higher access to the basic needs like nutrition, water, fuel, electricity etc. The study finds that it has improved the status and position of women. Another report of the baseline survey titled ‘The Maturing of Indian microfinance : A longitudinal study’ (EDA, 2004) finds that microfinance increases enterprise activities and it has increased women’s recognised ownership of assets also their involvement in managing enterprise finance by micro credit.

2.7 SHG and Microfinance

Namboodiri and Shivani (2001) analyse the potential role of SHGs in Gujrat in terms of its weakness, strength and threat. The study reveals that the major weakness of SHGs is that they have limited scope for future growth in membership. Further according to them the major strength of these groups is that they are self-sustainable system of community organizations free from governmental; they are promoted by the NGOs, banks. Regarding the threat, author has mentioned that SHGs do not have any legal status.

M. Anjuman and T. Alaghmoni (2001) have undertaken a study in Madurai district of Tamil Nadu with the objective of assessing the economic, social and institutional impact of microfinance through SHGs. The case study has early indicated that if the group formation is correct, there would then be positive impact on all these above aspects.

Sinha and Patole (2002) point out that the core feature of SHGs is the voluntary savings by the members which is initially used to finance credit requirements of members. Dasgupta (2001) focuses on some of the benefits of these groups-
remarkable empowerment of poor women, access to the required amount of credit and savings mobilized by the poor, matching the demand and supply of credit structure and opening of new market for financial institutions.

Chakarbarti (2004) in his study, describe how all decisions on group contributions, loan sanction, interest rates on loans, repayment schedules, etc are made through unanimous resolution drawn at group meetings. He also refers to the important and crucial role of Self Help Promoting Institutions (SHPI) in formation and nurturing of SHG’s. It is the SHPI who most often are NGOs working in a particular area who initiate the process of forming SHGs.

P. Satish (2005), in his study finds that the first official interest in informal group lending took shape during 1986-87 on the initiative of NABARD and Self Help Group (SHG) was considered as the most successful channel for delivering of microfinance. He states that SHGs are formed around the theme of saving and credit. Unlike in the case of Grameen Model, the SHG completely controls the use of its funds. It is left to the women to decide the rate of interest at which they lend to members. T.S. Nair (2005) in her study points out that SBLP is the most successful in the microfinance sector. NABARD (2005), in its study analyses the role of SHG in delivering micro-credit. These studies find out that SBLP has emerged as the largest microfinance outreach programme in the world. Thus SBLP has become the answer of the poor to the formal banking system in availing credit, in a sustainable and cost effective manner.

Thus, the SHGs have become regular component of the Indian financial system since 1996. According to Rangarajan (2005) SHG is a savings and credit group with 10-20 numbers who belong to same economic strata, usually women from the poor economic strata, regularly contributing a small savings to a common fund managed by the members themselves. From this fund, loans are given to the members for both
production and consumption purpose. These SHGs are small, informal and homogenous groups of not more than 20 numbers each (NABARD, 2000).

According to A.P. Pati (2006), the basic pillar for success of SHGs is its discipline. He has shown the best practices in SHG through the following chart (1):

**Chart: 1: Best practices in SHG**

- Continuous savings
- Opening of savings account.
- Deciding on how to use the loan and setting its own teams and conditions.
- Internal rotation of savings.
- Conduct of meetings with specific agenda.
- Thrift and credit
- Operations taking place in the group meetings.
- Rotation of leader
- Transparent and democratic decision making.
- Financial discipline, accounting.
- Non-exploitation of members needs.
- One for all and all for one
- Urge for increase of corpus.
- Determination for economic and social development
- Regular Meeting

Many studies have been undertaken by various authors to analyse the role and function of SHGs in different parts of the country.

### 2.8 SHG and Microfinance in North-Eastern Region (NER)

In the context of NER not many studies have been undertaken till now. Borbora and Mahanta (2001) have done a study where they try to give an idea about the progress of SHG bank linkage programme and credit and saving programme (CSP) of Rastriya Grameen Vikas Nidhi (RGVN) in Assam. They find a positive result in terms of
reach and linkage. Another study undertaken by N.M. West (2001) also finds a progressive result of SBLP in Assam.

From the annual reports of Rastriya Gramin Vikas Nidhi (RGVN), some information about SHGs and microfinance can be traced out. The Credit and Saving Programme (CSP) of RGVN was initiated in 1995 with the objective of providing credit and other financial services to the poor who cannot access to the formal sector, in four areas; two each in Assam and Meghalaya. Having completed almost 11 years since implementation, RGVN-CSP has as on 31.03.2006 made its presence felt in I (Is it one district or more) districts of Assam covering more than 600 villages. RGVN has also made substantial progress in grooming NGOs and SHGs under NGO support programme and CSP.

Debabrata Das (2006) studies the impact of SBLP on beneficiaries of SHGs in Assam where he points out that after the linkage to bank, SHG members get more benefits in terms of more employment opportunities, reduction of poverty and growth of banking transaction among the members.

A.P. Pati (2006) in his study in the state of Meghalaya states that in Meghalaya the linkage of SHGs although started after 2001, with a great pace, still has not caught up with its neighbour i.e. Assam. The intra district variations are very high and till today out of seven districts three of them are at very nascent stage of linkage activities.

Umdor (2006) also states that SBLP in Meghalaya is very slow. From 2001-02 to 2004-05, only 89 new SHGs were credit linked under the SBLP and all these are from West Garo Hills. It is only in 2005-06 that a record of 486 new SHGs was credit linked under the programme in Meghalaya. This study also finds that amongst the various SHG credit- linked programmes in Meghalaya, the Swarnajayanti Gram Swaranjgarh Yojona (SGSY) has been the most successful one.
Summary

The review of existing literature provided in the preceding sections brings out the definition, importance and various operational aspects of both these institutions i.e. microfinance and SHGs. The review also discusses, in the Indian context, the success of SHG-Microfinance linkage programme. The review suggests that in the past few years, savings led microfinance has gained recognition as an effective way to bring very poor families to capture the low-cost financial services. However majority of the studies reviewed above, are in the context of different states/regions excluding the NER. These two institutions and the linkage between them as mechanisms of rural development and poverty alleviation are very recent to NER. In this region, to the best knowledge of this researcher, not many systematic studies have been undertaken on different aspects of the linkage between these two institutions. A few of the studies which have been undertaken as reviewed above are very general in nature. They do not explain the various important dynamics of the SHG-Microfinance linkage programme. For example, the various reasons for growth of this SHG-Credit linkage programme have not been looked into by any of these studies. To make the SHG-credit linkage programme a success, a systematic understanding and analysis of some of these programmes should be made both at the aggregate and disaggregate level. In the NER, Assam happens to be the state where, in comparison to other North East states, the progress of this linkage programme is better particularly in terms of coverage. Therefore, we feel that a systematic study on the growth and other dynamics of this SHG-Microfinance linkage programme, will be timely and worth pursuing. However as the study is going to be undertaken by this scholar for her M.Phil thesis, the usual limitations of resources and time prevail.