Chapter- 1

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INTRODUCTION

1.1 Introduction

Today, for the developing countries, the main challenge is to achieve people centered faster sustainable growth by strengthening and expanding the nations' productive capacity. Poor and least developed countries are yet to bridge the gap between themselves and more wealthy countries. Hunger, destruction of the environment both by man and nature, and population growth in the past 30 years have overshadowed progress achieved in many Asian and other Third World countries. In view of this, the poor countries must initiate their own remedial processes with sober rethinking on the historical and concurrent inventories and incorruptible projections by taking account of all geo-economic and ethno-physiological factors. Only meaningful productive activities supported by timely provision of financial services and credit in adequate measures would help the poor to emerge out of their poverty and lead to the path of sustainable development.

Amartya Sen has convincingly argued that poverty is not merely insufficient income, rather the absence of a wide range of capabilities, including security and ability to participate in economic and political systems.\(^1\) Recognising this, the World Bank's *World Development Report 2000 / 2001* identifies three priority areas for efforts to address poverty: *promoting economic opportunity, facilitating empowerment and enhancing security*.\(^2\) In this pursuit, *microfinance* has much to offer with its new dimensions in order to reach the unreached and provide hassle free services to the needy.

1.2 Statement of the Problem

In spite of the massive scale of government intervention towards rural development in India, rural India continues to be reeling under poverty and related problems. Notwithstanding the phenomenal progress seen in the rural credit structure in terms of volume of credit extended, concessionality, coverage of weaker sections including scheduled castes and tribes, almost all institutions constituting the formal part of the rural credit system, suffer from several shortcomings like; (a) Gap between the concern of the policy makers and the quality of the effort (b) Defects in policy design (c) Infirmitities in implementation (d) Loans to the poor were considered as a part of social sector lending and not commercial (e) It was felt that poor were not borrowers but beneficiaries (f) An attitude of ‘carefully disguised cynicism towards the poor’ and (g) An attitude of ‘poor are not bankable’.

This possibly has been due to the absence of the people’s participation in the development programmes and also due to the gap in mutual understanding about perspectives of the supply side (the government, planners, and the bureaucracy) on the one hand and the demand side (the rural poor) on the other. This gap is felt to be filled by the microfinance activity through the Self Help Group approach for sustainable rural development.

The significant feature of the Self Help Groups [SHGs] is that they provide credit to the poor at unsubsidized interest rates besides having relatively low default rates on these loans. SHGs reduce transaction costs of financial institutions that do business with the poor and that of the SHGs themselves. They reduce the cost of

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financial institutions by acting as intermediary organisations or by providing social collateral that substitute for costly loan appraisals and supervisions. SHG approach has made considerable impact on the development of rural economy in terms of increasing savings of the poor, providing access to credit for the poor at reasonable rates of interest by establishing linkages with the formal financial institutions, improving the production levels and income levels, increasing food security and standard of living, improving asset creation and enhancing income generation activities, augmenting environment sustainability and contributing for the much needed women empowerment. With the enthusiastic roles played by the NGOs, the banks, the public and the governments, over a period of one and a half decade, the SHG approach has transformed into a movement in the rural areas.

In this context, it is desirable to generate information and analyse to what extent these Self Help Groups have been able to reduce poverty and vulnerability by: increasing capital / asset formation at the household level, improving household and enterprise incomes, enhancing the capacity of individuals and households to manage risk, increasing enterprise activity within households, expanding employment opportunities for the poor in non-farm enterprises, empowering women and improving the accessibility of other financial services at the community level.

1.3 Review of Literature

In order to create a foundation for the study, to understand the various nuances and dimensions of the topic of study as well as to prepare a proper methodology and framework for the study, elaborate efforts have been made to review the available

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4 Ajai Nair, Woodrow Wilson School of Public and International Affairs, Princeton University: “Sustainability of Microfinance Self Help Groups in India: Would Federating Help?”

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literature on the topic. With a view to present the review of literature in an orderly approach it is arranged in two sections. While the first section includes research studies and related literature the second section includes the publications, articles and the lectures related with the subject.

1.3.1 Section 1: Review of Studies on Self Help Groups

Piyush Tiwari and S.M. Fahad argue that more than subsidies poor need access to credit. Absence of formal employment makes them non-bankable. This forces them to borrow from local moneylenders at exorbitant interest rates. Many innovative institutional mechanisms have been developed across the world to enhance credit to poor even in the absence of formal mortgage. The paper discusses conceptual framework of a microfinance institution in India. The successes and failures of various microfinance institutions around the world have been evaluated and lessons learnt have been incorporated in a model microfinance institutional mechanism for India.

Richard L. Meyer (2001) observes that microfinance can contribute to poverty alleviation and food security. It does this through supplying loans, savings and other financial services that enhance investment, reduce the cost of self-insurance, and contribute to consumption smoothing. India has expanded microfinance, but it has not yet developed a strong system capable of serving massive numbers of poor in a sustainable fashion. Undoubtedly, the legacy of directed credit with its top-down approach to lending and the prevalence of highly subsidized state and national poverty projects and programmes retard the development of true market-oriented rural microfinance. The policy of supporting SHG linkages with banks has merit in a
country with a large bank network, but it should not be the only model encouraged. Additional efforts are needed to create and nurture competitive MFIs willing to experiment with other models.

Puhazhendhi V. and K. J. S. Satyasai (2000) have observed that SHG–bank linkage programme has significantly contributed to the improvement in savings, improvements in assets, improvement in income levels and social conditions of the rural people.

Y.C. Nanda observes that, microfinance is a useful tool in building the capacities of the poor in management of sustainable self-employment activities besides providing them other financial services like savings, housing and consumption credit.

S.M. Sheokand has analyzed the SHG-bank linkage approach. He observes a win-win situation for both the Banks and the SHGs. Further, he observes that given the size of the country and incidence of poverty in India the progress under the linkage programme can be considered as a modest. He opines that there is also a regional concentration of progress in southern India.

Dr. V. Puhazendhi (2000) describes the significant impact of SHGs on social empowerment, empowerment of women, employment generation, credit absorption, new income generating activities, savings pattern etc, in his study of SHGs in the state.

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6 Richard L. Meyer Rural Finance Programme The Ohio State University Columbus, OH 43210 December 31, 2001
Microfinance, Poverty Alleviation, and Improving Food Security: Implications for India

Microfinance for Rural People: An Impact Evaluation

8 Y.C. Nanda Managing Director NABARD Task Force on Supportive Policy and Regulatory Framework for Microfinance

of Tamilnadu. Further, he opines that the creation of income generating assets / activities through loans availed from banks has made significant impact on the overall economic status of the group members. He also points out that there is a positive impact of employment generation on 40 percent of the group members who had undertaken income generating activities\(^{12}\).

**Susy Cheston and Lisa Kuhn** explain that microfinance has the potential to have powerful impact on women's empowerment. Although microfinance is not always empowering for all women, most women do experience some degree of empowerment as a result. Women need, want, and profit from credit and other financial services. According to them, access to credit may be the only input needed to start women on the road to empowerment\(^{11}\).

**Girija Srinivasan** (1995) illustrates that, realization of the poor women that they can take charge of their lives is a more significant gain of the SHGs. The confidence of the women that they can deal with external and modern institutions besides the feeling that they have competence to access and use finance and resources is another important gain. Further, she opines that access to financial resources is important for the development of poor women\(^{12}\).

**Prof. Dr. Hans Dieter Seibel and Harishkumar R. Dave** have assessed the commercial aspects of SHG-bank linkage. According to them, the SHG-bank linkage Programme is the largest non-directed micro-savings and micro-credit programme in the developing world; and its bank lending rates – fluctuating at market rates around

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11 Susy Cheston and Lisa Kuhn - Empowering Women through microfinance
12 Girija Srinivasan (1995). Group Approach to Empowerment of Rural women-IFAD Experience
7% in real terms – are among the lowest. The Study applied average cost analysis, attributing all costs duly to each product; and marginal cost analysis in response to the advice of bank managers to ignore personnel costs of SHG banking because of existing idle capacities. Main performance indicators are non-performing loans, return on average assets, and operational self-sufficiency. This methodology was applied to seven units of three banks in October 2002. The results are indicative only:\(^\text{13}\):

- **Non-performing loans** to SHGs were 0%, testifying to the effectiveness of group lending to the very poor. In contrast, consolidated Non-Performing Loans (NPL) ratios ranged from 2.6% to 18%; and of Cash Credit (CC) and Agricultural Term Loans (ATL) up to 55% and 62%, respectively.

- **Returns on average assets of SHG Banking** ranged from 1.4% to 7.5% by average and 4.6% to 11.8% by marginal cost analysis, compared to –1.7% to 2.3% consolidated. The operational self-sufficiency (OSS) of SHG banking ranged from 110% to 165% by average and 142% to 286% by marginal cost analysis, compared to 86% to 145% consolidated. In contrast, Return on Assets (ROA) of Cash Credit varied from –10.2% to –0.5% and of ATL from –6.3% to 0.2%; OSS ratios from 54% to 102%. SHG Banking was found to be a robust financial product, performing well in healthy and distressed financial institutions.

**Dr. V. Pushazendhi** and **K.C. Badatya** have made a study of impact assessment of the SHG-bank linkage Programme in India. The study is based on primary details collected from 115 members in 60 SHGs. The socio-economic conditions of the members were compared between pre and post SHG situations to quantify the impact.

\(^{13}\) Prof. Dr. Hans Dieter Seibel, University of Cologne, Germany and Harishkumar R. Dave, Deputy General Manager, mCID, NABARD, Commercial Aspects of SHG Banking in India
There was a significant increase in the asset structure, mean annual savings, average loan per member, overall repayment percentage, average annual net income, employment per sample households. Availing loans from moneylenders and other informal sources with higher interest rate was significantly reduced due to SHG intervention. There was remarkable improvement in social empowerment of SHG members in terms of self-confidence, involvement in decision-making, better communication, etc. The study findings concluded that SHG-bank linkage Programme has made significant contribution to social and economic improvement of the member households of SHGs.

**Girija Srinivasan** opines that SHGs have had a beneficial impact on their members. The positive impact of SHGs on the poor in providing them access to resources, economic choices, social strength, and control over their own lives, functional literacy and an empowering climate is obvious. Further, she opines that SHGs should not be held as panacea for whatever affects the poor people.

**Dr. Erhard W. Kropp and Dr. B S Suran** observe that the SHG-banking pioneered and promoted by NABARD has emerged as a primary microfinance service mechanism for the unbanked poor in India. The multiple initiatives led by capacity building have made tremendous influence on the conventional bankers' mindset. They now view SHG-banking as a new dimension of quality portfolio with very low risks and with marginal increase in operating costs. *The dimension and flexibility in SHG-banking now practiced in India is unmatched in world's banking system.*

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14 Dr. V Puhazhendhi and K.C. Badatya, DEAR, NABARD, SHG-bank linkage Programme for Rural Poor – An Impact Assessment

15 Girija Srinivasan (Eds), Building a Future-Group by Group: Case studies on Self Help Groups in India, Bankers Institute of Rural Development, Lucknow.
Being predominantly participated by women, SHG-banking is the first step towards feminisation of the (micro) banking portfolio of Indian banks. Stimulating self-help capacity of the poor does spark off the entrepreneurial enthusiasm, risk mitigation mechanisms in low-income households; it also serves as an entry-road to overcome poverty and addressing other crucial social concerns\textsuperscript{16}.

**Prof. Malcolm Harper**, microfinance specialist of international fame has studied the role of SHPIs in promotion of SHGs sponsored by NABARD. The objective of this study was to examine and compare the different ways in which Self Help Promotion Institutions (SHPIs) promote Self Help Groups (SHGs) in order to enhance the efficiency and quality of the SHG promotion process\textsuperscript{17}.

The following are the major findings in brief:

1. The banks, particularly co-operatives, are likely in the medium term to be the main SHPIs. They should support and eventually be replaced by SHG members' own initiatives.

2. The SHPI roles of SHG federations and of non-volunteer individuals should be examined.

3. Incentive schemes for NGOs and individuals should be redesigned and tested in order to cover the full costs of the SHPI.

4. Training should include hands-on SHG record keeping, SHG promotion for lower grade bank staff and improved understanding of the importance of access vs. the cost of finance.

\textsuperscript{16} Dr. Erhard W. Kropp (formerly Senior Economist, GTZ, and Consultant) and Dr B S Suran, mCID, NABARD, Study of Linking Banks and (financial) SHGs in India, Published by NABARD

\textsuperscript{17} Professor Malcolm Harper, Microfinance Expert at World Bank. Role of SHPIs in promotion of SHGs, published by NABARD
5. The management of the schemes to encourage SHG promotion should be experimentally delegated to banks, in order to avoid the problems caused by NABARD's thin district representation, and to take full advantage of the banks' greater field coverage.

**Mr. Aloysius P Fernandez** studied the impact of Self Help Groups on the social / empowerment status of women in India. It was found from the Study that members in three year old groups perceive themselves as stronger on almost all the studied parameters, with the exception of a few parameters where the difference between the one year old and three year old groups is not very significant (except in the case of moderating group level conflicts, where the newer members express higher confidence levels).^18

1.3.2 **Section 2: Review of Literature related to the Subject**

**Stanley Fischer** (2003) observes that not only can microfinance help people emerge from poverty, but also can be an effective strategy to reach other Millennium Development Goals, particularly those relating to promoting children’s education, improving health outcomes for women and children, and empowering women. Improvements in these areas can be sustained only when households have increased earnings and greater control over financial resources^19.

**James Copestake, Susan Johnson** and **Katie Wright** (2002) emphasise that microfinance services contribute to development by adding value (benefits to society exceed costs). They state that the key equation is whether costs of provision are less

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18 Mr. Aloysius P Fernandez, Executive Director, MYRADA - Impact of Self Help Groups (Group Processes) On the Social/Empowerment Status of Women Members in Southern India - published by NABARD

than the benefits (net of transaction costs) to clients. If they are, then business is possible, with benefits shared between provider and user according to the price that is struck between them. The scope for business can be enhanced by lowering the cost of provision of the services, as well as by developing new products that better serve the needs of clients.

David Hulme argues that improving Impact Assessment (IA) studies will require both better ‘science’ and better ‘art’. Impact assessments can be viewed as laying on a continuum between ‘proving impacts’ and ‘improving practice’. While many different groups have interests in IA there is currently great pressure on donor agencies to prove impact. Different conceptual frameworks provide the foundations for all Impact Assessments. These must cover a model of the impact chain, the identification of units (levels) of assessment and the specification of the types of impact to be assessed. The range of methods used for IA extended over the last decade have been - sample surveys, rapid appraisal, participant observation, case study and participatory learning and action. Each method has particular strengths and weaknesses. The choice of methods must be based on objectives, costs and feasibility. Mixed methods have much to recommend them.

Martha Alter Chen and Donald Snodgrass (1999), in their study “An Assessment of the Impact of Sewa Bank in India: Baseline Findings” observe that participation in micro enterprise services leads to an increase in the level of household income. According to their study, the average income of borrower households was

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21 David Hulme, Institute for Development Policy and Management University of Manchester, Oxford Road Manchester M13 9GH UK, Impact Assessment Methodologies for Microfinance: Theory, Experience and better Practice.
higher (by 39%) than the average for non-member households. Further, they have observed that participation in micro enterprise services leads to an increase in expenditures on food, especially among the very poor. Average daily expenditure on food was reported to be Rs. 61 per day per household, equivalent to Rs. 1,830 per month. This represents 53% of reported monthly household income (Rs. 3,460). The percentage is plausible, since low-income households worldwide typically spend half or more of their income on food, and suggests that income and food expenditure have been measured with reasonable consistency. Average daily expenditure on food in borrower households, at Rs. 68, is 21% higher than in control households.

Carolyn Barnes and Jennifer Sebstad (2000) have presented useful guidelines intended to guide the planning, design and conduct of microfinance impact assessments that are credible, useful, and cost effective. They center on Impact Assessments (IAs) that can be used by microfinance providers, microfinance promoters, donors, and development policy makers to improve microfinance products and services and justify investments in microfinance programmes. The guidelines aim to inform decisions about the type of impact methodology to use in light of different IA objectives, programme contexts, and resources. They cover both qualitative and quantitative impact assessment methods and highlight the potential role of each.

1.4. Scope of the Study and Research Gaps

In terms of scope, the study covers more particularly the economic impact of Self Help Groups on the development of rural economy. Impact in this study is

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defined as: *change that can be plausibly associated with participation in a SHG programme.*

Research gaps

Up till 2001, the SHGs had been subject to evaluation studies, which were not mostly comprehensive in nature. As a result, in 2001-02 NABARD commissioned a series of evaluation studies that were conducted by academics, consultants and practitioners from India and around the world, in order to look comprehensively into the challenges and opportunities facing the programme. Although these studies probably provided some systematic analysis of the experience, it is felt that they share a number of limitations.

Studies mentioned above in the review of literature have focused on various aspects of SHG-bank linkage programme with reference to banks and SHG members. However, these studies provide only some glimpses of the trends of formation of SHGs, their linkage with banks for credit and the consequent socio-economic impact on the rural poor in terms of very few parameters of evaluation.

This has prompted the need for a detailed study with proper research methodology to evaluate the economic impact of Self Help Groups on the development of rural economy encompassing all the relevant variables for evaluation of a development intervention.

1.5 Conceptual Model

Since the topic of study covers wide range of aspects relating to the field of rural development encompassing microfinance through Self Help Groups, the
conceptual models and related theoretical framework is explained in detail in the chapter - 3 titled-\textit{Theoretical Framework and Empirical Experiences}.

1.6 Objectives of the Study

It is generally felt that there have been perceptible changes in the living conditions of the rural poor mainly on economic side and relatively on social side owing to the role of Self Help Groups. Also, it is widely believed that characteristics of SHGs such as access to timely credit, transparency with simple accounting procedure, elimination of middlemen and group empowerment have been the other motivating factors. It is with this perceptual background that this detailed study has been undertaken to find out the economic impact of the Self-Help Groups on the development of rural economy. Impact assessment in this context implies questions about outreach and effectiveness in meeting development objectives.

In the light of this, the following are the objectives of the study:

1. To evaluate the economic impact of Self Help Groups with reference to; 
   \textit{capital formation through savings mobilisation, credit \textendash savings ratio, interest rates and repayment performance}.

2. To evaluate the economic impact of SHGs on; \textit{production levels, asset creation levels, food security and standard of living}.

3. To ascertain whether microfinance leads to employment generation and reduction in poverty.

4. To find out which products/ models of SHG-bank linkage are most effective in reaching the poor, responding to the needs of the poor – and at the same time providing a cost-effective and sustainable microfinance service in terms of
transaction cost of lending for banks, transaction cost of borrowing for the poor, costs of co-ordination and management and risk cost of funds for financial intermediaries.

5. To understand the role of Self Help Groups Approach in achieving empowerment of women and to discern the impact of Self Help Groups in terms of reaching the weaker sections of the society.

### 1.7 Hypotheses

This impact study intends to explore the following hypotheses:

**Hypothesis 1:** Self Help Group approach builds the capacity of individuals, households, and micro-enterprises to manage risks by increase in savings and its utilization, increase in employment generation, improvement in asset holding, effective utilizations of credit, credit-savings ratio, interest rates, repayment of loans, etc.

**Hypothesis 2:** Self Help Group approach contributes to increase in production levels and reduction in the incidence and severity of poverty among clients through improvements in household income.

**Hypothesis 3:** Self Help Group approach is an effective strategy for extending financial services to the poor and other disadvantaged groups not reached by formal sector finance, in terms of transactions cost both for the banks as well as the poor borrowers of SHGs.

**Hypothesis 4:** Self Help Group approach contributes to empowerment of women by providing them access to economic resources and influence over their uses, participation in economic decision-making, opportunities for self
development, skill development and thereby enabling them to participate in socio-political decision-making.

**Hypothesis 5:** Self Help Group approach combined with other supportive interventions (like non-financial services, social mobilization, and other forms of social protection) has greater impacts in reaching the women, SC/ST, and other weaker sections of the society.

1.8 **Significance of the Study**

Self Help Groups have been receiving greater attention by all the concerned like the Government, NABARD, RBI, Commercial Banks, and RRBs. This innovative form of credit delivery is catching up in a big way in rural areas. SHG movement is leveraging the strength of the formal banking system and flexibility of informal SHGs in providing adequate financial services to the rural poor. The programme has turned into a social movement with high expansion rates in recent years. Fuelled by competence and enthusiasm at all stakeholder levels, it is expanding rapidly throughout India, including tribal areas. It is probably the world's largest and most successful microfinance programme for the rural poor-outstanding in its emphasis on self-reliance and local autonomy of the very poor.

It is widely felt that there have been perceptible changes in the living conditions of the rural poor mainly on economic side and relatively on social side. It is with this perceptual background that a detailed study has to be undertaken to find out the economic impact of the Self-Help Groups on the development of rural economy.
1.9 Study Area

In India, southern region has dominated the SHG-bank linkage programme since the launch of the Pilot project to link SHGs with banks. In terms of cumulative number of SHGs linked with banks, Karnataka has been among the top three, the other two being Tamil Nadu and Andhra Pradesh. In Karnataka state, Shimoga has led the way in the formation and linkage of SHGs with banks.

Shimoga district has been among the front running districts in the state of Karnataka in the SHG-bank linkage programme. The district provides an ideal region to undertake the study in view of the diverse culture, climate encompassing the maidan region (temperate plain region) consisting of Shikaripura, Soraba, Shimoga and Bhadravathi blocks and malnad region (hilly forest region) consisting of Thirthahalli, Sagara and Hosanagara blocks endowed with majestic Sahyadri hill ranges and thick forest cover.

In terms of SHGs linked with bank credit among the districts in the state of Karnataka, Shimoga district with linkage of 5554 SHGs stands 13th with a share of 9%. There are about 8408 SHGs in the district as on 31.03.2005 and about 5554 of them have availed credit support from banks so far. As at March 2003 (the reference period), in Shimoga district there were in all 4621 SHGs of which 2755 SHGs were linked with bank loans.

Some of the salient features of the district which prompted us to select this district as study area are presented below:

✓ Shimoga district has the distinction of having 2755 SHGs linked to the banks under linkage programme with cumulative bank loan disbursed upto Rs. 83.91 Crores by March 2003.
✓ The pioneer to the linkage programme erstwhile Sahyadri Gramin Bank with head office at Shimoga has linked 1420 SHGs with cumulative bank loan of Rs. 55.04 Crores by March 2003.

✓ The district provides an ideal region to undertake the study in view of the diverse culture, climate and people.

✓ The district has good mix of quite old and new SHGs ranging from 12 years to 1 year old.

✓ Apart from the erstwhile Sahyadri Gramin Bank, about 15 to 20 NGOs are actively engaged in SHG formation and linkage programme.

✓ The State Government Sponsored ‘Stree Shakti’ SHG programme for women has been catching up in a big way with the formation of more than 500 SHGs during last year.

Therefore, we have selected Shimoga district as a study region since all the indicators are very well stabilised.

1.10. Reference Period

The Self Help Group promotion movement has gathered momentum since 1993 and there has been phenomenal rise in the number of SHGs due to the active support of banks, NGOs, Government Organisations and Non Government Organisations. For the purpose of study it is decided to consider a ten-year period upto 2003 as a suitable period for the study. Accordingly, March 2003 has been reckoned as the reference period as the subject study was also commenced during this period.