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# Micro finance as a reformatory tool – A focus through the SHGs

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**Abstract**
Microfinance is a landmark reformatory tool in the financial sector in India. The deprived section of the society through the Self Help Groups got an elevation to the accessibility of finance, organizing through the associations and groups. The empowerment of women has always been an agenda of the governments both central and state. Discrimination met through the caste, sub-caste, religion and the like has made the micro credit to be giving necessary impetus to the people at large. The present conceptual study is a step in the direction to look into the Micro finance from the Self Help Groups perspective.

**Keywords:** Self-help groups, microfinance, women empowerment

## 1. Introduction [1]

Microfinance is the provision of financial services to low-income clients, including consumers and the self employed, who traditionally lack access to banking and related services. Microcredit, or microfinance, is banking the unbankables, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral. In general, banks are for people with money, not for people without." (Gert van Maanen, Microcredit: Sound Business or Development Instrument, Oikocredit, 2004) is based on the premise that the poor have skills which remain unutilized or underutilized. Microcredit fits best to those with entrepreneurial capability and possibility.

Ultimately, the goal of microfinance is to give low income people an opportunity to become self-sufficient by providing a means of saving money, borrowing money and insurance. The main aim of microfinance is to empower women. Women make up a large proportion of microfinance beneficiaries. Traditionally, women (especially those in underdeveloped countries) have been unable to readily participate in economic activity. Microfinance provides women with the financial backing they need to start business ventures and actively participate in the economy. It gives them confidence, improves their status and makes them more active in decision-making, thus encouraging gender equality. According to CGAP, long-standing MFIs even report a decline in violence towards women since the inception of microfinance.

The most of the microcredit institutions and agencies all over the world focuses on women in developing countries. Observations and experience shows that women are a small credit risk, repaying their loans and tend more often to benefit the whole family. In another aspect it´s also viewed as a method giving the women more status in a socioeconomic way and changing the current conservative relationship between gender and class when women are able to provide income to the household. There are many reasons why women have become the primary target of microfinance services.

## 2. International institutions and micro finance

A recent World Bank report confirms that societies that discriminate on the basis of gender pay the cost of greater poverty, slower economic growth, weaker governance, and a lower living standard for all people. At a macro level, it is because 70 percent of the world's poor are women. Women have a higher unemployment rate than men in virtually every country and make up the majority of the informal sector of most economies.

They constitute the bulk of those who need microfinance services. Giving women access to microcredit loans therefore generates a multiplier effect that increases the impact of a microfinance institution's activities, benefiting multiple generations.

NABARD (2005) explains that the Self Help Group is a group with "an average size of about 15 people from a homogenous class. They come together for addressing their common problems. They are encouraged to make voluntary thrift on a regular basis. They use this pooled resource to make small interest bearing loans to their members. The process helps them imbibe the essentials of financial intermediation including prioritization of needs, setting terms and conditions and accounts keeping. This gradually builds financial discipline in all of them.

They also learn to handle resources of a size that is much beyond the individual capacities of any of them. The SHG members begin to appreciate that resources are limited and have a cost. Once the groups show this mature financial behavior, banks are encouraged to make loans to the SHG in certain multiples of the accumulated savings of the SHG. The bank loans are given without any collateral and at market interest rates. The groups continue to decide the terms of loans to their own members. Since the groups' own accumulated savings are part and parcel of the aggregate loans made by the groups to their members, peer pressure ensures timely repayments." In this paper the role played by Microfinance in women's empowerment are considered into three dimensions namely psychological, social and economical.

**3. A description of microfinance [2]**

Microfinance is a way to help alleviate poverty in rural communities that lack access to formal banking. Different studies fluctuate on the number of poverty stricken people in the world, but some studies say that around 300 million to 360 million are in "absolute poverty" (Premchander 2009, 1). Furthermore, research has shown that over 2 billion people do not have access to formal credit institutions (Hudon 2008, 17). Access to financial resources helps people generate income and lessen poverty around the globe. Since microfinance is a system that distributes small loans to poor people in order for them to generate income and start their own small businesses, it has the ability to lessen poverty as well as promote entrepreneurship, social and economic development in poor communities (Lazar 2008, 34).

**4. Features of microfinance [3]**

1. It is a tool for empowerment of the poorest.
2. Micro credit is delivered normally through Self-Help-Groups.
3. It is essentially for promoting self-empowerment and productivity in the formal sector of the economy.
4. It is generally used for direct income generation and consumption smoothing.
5. Loans are small amount – micro loans.
6. Short duration loans.
7. Loans are offered without collaterals.
8. High frequency of payments.
9. Loans are generally taken for income generation purpose.

**5. Significant initiatives of micro finance [4]**

The following have been the significant initiatives:

- Setting up of the Rashtriya Mahila Kosh to re-finance microfinance activities of NGOs
- Encouraging National Bank for Agriculture and Rural Development (NABARD) to set targets for the self-help group (SHG) – Bank linkage programme
- Emergence of Sidbi Foundation for Micro-Credit as a financier of microfinance institutions (MFIs)
- The pronouncements of the Reserve Bank of India (RBI) from time to time – such as
- including lending to SHGs as a part of priority sector targets
- exempting non-profit companies doing microfinance from registering as as an NBFC
- permitting the establishment of local area banks (now withdrawn)
- Routing some poverty oriented schemes such as the Swarnajayanti Gram Swarozgar Yojana (SGSY) through SHGs
- The close linkage built by DWCRA schemes
- The initiatives of various state governments in promoting schemes such as Swa- Shakti (Gujarat), Velugu (Andhra Pradesh)

**6. Commercial microfinance institutions [5]**

The nature of the other independent MFIs must be examined to understand the type of intervention from the State that could help the sector. Most MFIs in the country are promoted by NGOs or entrepreneurs with an NGO background. Usually the microfinance starts as a division of the NGO and grows large enough to warrant a spin off into a separate organization. However, organizations incorporated as Trusts, Public Societies and not-for-profit companies are not designed to undertake commercial activities of borrowing and lending.

The intent of these forms of incorporation was to receive individual or bulk donations and carry out charitable activities. A legislation governing charitable activity is inappropriate for microfinance. We also know from experience that people with commercial capital are unlikely to invest in microfinance business. The skills required for running a microfinance business comes from social mobilisation – present in the developmental arena. Similarly, it is unlikely that MFIs will grow to large commercial banks.

Though there are counter-examples for this in other parts of the world – such as Bancosol in Bolivia and the BRAC Bank in Bangladesh, these experiments are few and far between. By identifying the limitations of growth of MFIs and the source of capital we are able to advocate a regulatory framework for carrying out microfinance. We need to be sure that the framework thus provided is not vulnerable to misuse by the other players who are likely to come in the garb of providing microfinance.

Given this, the state has to recognize that there are interested developmental professionals, willing to work, have the necessary social mobilization skills but lack capital. Capital for MFIs flows through the charitable route because of the interests of the donor agencies. However there is no mechanism of getting developmental capital as risk capital. The donor agencies are prohibited from making equity investments in commercial companies. However, they are willing to institute a permanent fund that can be rotated and grown.

These funds by definition are routed into the not-for-profit entity. These entities are not permitted to invest in commercial microfinance operations because of their tax status. While one recognizes the fact that no tax exemption is to be granted for commercial activities, the regulations do not permit partial taxation for the commercial division of a not-for-profit entity. As a result, there is a danger that the NGOs lose the tax exempt status even if they continue the microfinance operations under the inappropriate form of a charitable organization. Therefore it is best for the state to allow for not-for-profit entities to invest in commercial microfinance.

The caveats to be taken here are:

1. Having a definition of microfinance
2. Defining the ownership (the experience of Bolivia in formation of FFPs is useful)
3. A plan to ensure that the operations of the commercial division are not subsidized by the non-profit entities
4. A plan to make these two entities de-mutualised over a longer time frame.

The issue of taxation should not pose a great problem as microfinance will be carried out by distinct commercial entities and therefore gain no special benefits. Since dividends paid to the promoters (including not-for-profit trusts) will be post tax (and under the current regime subject to dividend distribution tax) the state should not be worried about any loss of revenue. This would attract more capital and would help the private initiatives of microfinance grow organically.

## 7. Adoption of micro finance [6]

In India, the adaptation of the new microfinance approach by rural financial institutions assumed the form of the “Self-Help Group–Bank Linkage Program.” After an initial pilot study the RBI set up a working group on non-governmental organizations (NGOs) and SHGs. The working group made recommendations for internalization of the SHG concept as a potential intervention tool in the area of banking with the poor. The RBI was quick to accept the recommendations and advised the banks to consider mainstreaming lending to SHGs as part of their rural credit operations.

## 8. Advantages of micro finance [7]

| Parameter | Money Lender | Commercial Banks | Govt. Sponsored Programs | Financial products of MFIs |
|---|---|---|---|---|
| Ease of Access | High | Low | low | High |
| Transaction cost of Access | Low | Very high | Very high | Low – Medium |
| Loans | Very Short | Extremely Long | Extremely long | Short |
| Repayment Terms | Fixed and Rigid | Fixed and Easy | Fixed and Easy | Flexible |
| Interest Rates | Exorbitantly High | Low and very Affordable | Low, Affordable and Subsidised | Reasonable and Affordable |
| Incentives | None | None | None | Repeat and larger loans, Interest Rebates |
| Repeat Borrowing | Possible | Possible but not likely | Possible but not likely | Stream of credit is assured |
| Loan Access Procedures | Very Quick | Extremely Time Consuming and complicated | Extremely Time Consuming and Complicated | Simple and Quick |
| Loan Application Procedures | Informal but exploitative | Exhaustive and Complex | Exhaustive and Complex | Simple and Informal |
| Collateral and Demand Promissory Note | Mandatory | Required but hypothecation of asset may suffice | Not required although a charge on the asset becomes automatic | Not required – social collateral is used for physical collateral |

**Source:** R. Arunachalam - Alternative Technologies in the Indian Micro- finance Industry

## 9. World scenario [8]

Studies in several countries point out that loans are sometimes used for consumption smoothing, not production. It has been pointed out that the poor often have short-term liquidity needs (frequently requiring lump-sum payments), which would normally be met by usurious moneylenders if other financial sources such as microcredit were not available. Sudden and debilitating shocks can force poor households into disempowering situations of distress. During the Asian economic crisis, self-help microcredit groups served as important cushions and safety nets. A high proportion of the funds made available for self-help microcredit schemes were utilized by women, enabling them to meet the subsistence needs of their families during those difficult economic times (ESCAP 2002). Many self-help programmes have also incorporated elements of savings, which can be used for purposes such as health insurance and emergency loans, thereby serving as private safety nets.

## 10. Micro finance in India [9]

The Indian micro finance sector is expected to grow nearly ten times by 2011 to a size of about Rs 250 billion from the current market size of Rs 27 billion, at a compounded annual growth rate of 76%. With about 42%of the population living below $1.25 a day in the country, the total demand for micro-credit in the country is Rs 550 billion at an average annual loan size of Rs 6,000. Thus, even by 2011 only about 50%of the market demand may be covered.

Operationally, the micro finance industry in India has borrowed largely from the Grammen Bank and similar institutions in the neighbouring Bangladesh, in terms of the methodology, processes and systems. Most of the leading Indian MFIs started out as NGOs during 1985-1999, adopting the Grameen Bank model of group-based lending to women in rural areas. Over the years, they have grown significantly in size and have transformed into commercial, for-profit Non Banking Finance Companies (NBFCs), thus moving towards a more regulated legal setup.

Between financial year 2004-05 and 2005-06, the combined loan portfolio of share Microfin Ltd, SKS Microfinance Pvt Ltd, and Spandana Sphoorty Innovative Financial Services Ltd, three of the largest NBFC MFIs in the country, showed a growth rate of 102%. Similarly, their combined outreach (number of active borrowers) showed a growth rate of 114% over the same period. All the three MFIs mentioned above now have much more than a million active borrowers each.

**11. Micro finance through shgs [10]**

1. Several non-government and co-operative organizations initiated savings and thrift led models for helping the poor and demonstrating that the poor have the urge to save and enjoy the grains of their savings through collective and mutually beneficial credit and micro finance arrangements.
2. Most of the micro finance models are working through financing directly or indirectly to Self Help Groups (SHGs). The SHGs constitutes 15-20 like minded people living below poverty line. Members of SHGs save equal amounts as decided by their groups. They open an account in either a bank or post office in the name of the group and authorize a member to operate the account.

**12. Conclusion**

The Self Help Groups were basically promoted to empower the downtrodden society, women and physically challenged and the like who suffer because of lack of resourcefulness be it finance, assistance to manufacturing and trading activities etc. The efficiency in managing the overall group of people is ensured. The principle of "by the people, for the people and of the people" is the tenet on which the SHGs function. SHG – Bank Linkage Program has significantly uplifted the accessibility to the financial services to the said section. The exploitation and isolation from the opportunities has been a concern of the society. The micro credit and the SHGs are a step in the direction.

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