## SHG AND MICRO FINANCE LINKAGE:

The origin of microfinance is quite absorbing. Microfinance combines the strengths of both formal and informal systems of purveying credit. Availability of hassle free credit in a systematic manner is the unique feature of microfinance system. Microfinance in informal system was in vogue in India in the form of chit funds, etc., since time immemorial. It came into existence under formal system with the advent of cooperative movement in India in the beginning of the last century. The microfinance is primarily based on the principles of co-operation namely, mutual help, democratic functioning etc. Though, the co-operative movement was initially envisaged with unlimited liability and small size of societies consisting of homogenous groups, over the years in the quest for improving the viability of co-operatives, large societies with limited liabilities were organized. This apart, the evolution of State partnership in co-operatives with entrenched bureaucracy etc., distanced co-operative movement from the spirit of microfinance movement.

Traditional efforts by Non Government organizations (NGOs) may reach poor clients, but are often unsustainable. Microfinance on the other hand, combines both outreach and sustainability. Such practice is perhaps most clearly embodied in the microfinance, which marries the best of the formal financial sector in terms of sustainability with outreach to poor clients of the development NGO.

Since independence, the Government of India in general and Reserve Bank of India in particular have made concerted efforts to provide the poor access to credit. However, the limited success of co-operatives forged the need for nationalization of commercial banks and later on establishment of Regional Rural Banks, which have mandated credit programmes for the low income households. Despite the phenomenal physical outreach of the formal credit institutions achieved in the past several decades, the rural poor continue to depend on informal sources of credit on account of the cumbersome procedures associated with formal credit. The credit needs are small, frequent, and usually emergent and they arise at unpredictable times. For the poor, the consumptive credit needs often precede and also determine their productivity.

## STRENGTHS OF INDIAN MICROFINANCE SECTOR

India is the largest democracy in the world. Unity in diversity is the greatest strength of India. Despite vast differences in terms of language, caste, religion, etc. driven by the co-operative spirit, people are interwoven with common affiliations and social obligations. The factors like personal rapport and proximity and like mindedness have added to the spread of the programme. Many SHGs have come into existence in India spontaneously and have exhibited tremendous democratic functioning and group dynamism. Their adroitness in assessing and appraising the credit needs of members, their business like functioning and efficiency in recycling the funds often with repayment rates nearing cent percent are additional positive features. Some of the best practices followed under microfinance sector in India include inter alia:

1. Broad based definition of microfinance.
2. Adoption of multi model approach.
3. Greater freedom to microfinance institutions.
4. Creation of Microfinance Development Fund.
5. The use of computers in microfinance and
6. Certain other important best practices.

**Greater Freedom to the Microfinance Institutions**:
i) RBI has allowed banks to formulate their own models or choose any conduit/ intermediary for extending micro credit. Banks are allowed to choose suitable branch / pocket / area where micro credit programmes can be implemented.
ii) Banks are permitted to prescribe their own lending norms keeping in view the ground realities.
iii) Banks are also allowed to devise appropriate loan and saving products and related terms and conditions including the size of loan, unit cost, unit size, maturity period, grace period, margins and purpose of borrowing including for housing and shelter needs.
iv) Interest rates on bank's loans given to microfinance institutions are completely deregulated.
v) Bank lending under microfinance is treated as part of priority sector targets as well as under sub-target of lending to the weaker sections.
vi) The microfinance institutions registered as not for profit NBFCs have been exempted from registration and prudential requirements. RBI has permitted such NBFCs to provide credit not exceeding US $ 0.001 million for business activity and US $ 0.003 million for meeting the cost of a dwelling unit to the poor.

## MICROFINANCE MODELS / APPROACHES IN INDIA

The following generic approaches to microfinance are commonly prevalent in India:
i. The basic SHG model with Commercial Bank linkage programme.
ii. The Federated SHG approach.
iii. The Rural Industries Promotion (SHG) Framework.
iv. The GRAMEEN Replicator Approach
v. The Urban Co-operative Banking Model
vi. The Multi-State Co-operative Solidarity Group Model
vii. The Enabling Co-operative Networking Framework
viii. The Co-operative - Grameen Hybrid Model
ix. The NBFC Approach

**Microfinance through SHG:**
During this phase – largely omitted in recent studies – NABARD focused on supporting NGO initiatives to promote SHGs and on analysing their potential and performance. In 1987 NABARD first put funds into the SHG/SAG movement (in response to a proposal from MYRADA submitted in 1986). In 1987 it provided MYRADA with a grant of 1 million Indian rupees to enable it to invest resources to identify affinity groups, build their capacity and match their savings after a period of 3-6 months.

**SHG Linkage:** Under this programme Microfinance has until now been carried out entirely in terms of disbursements, both annual and cumulative, rather than loans outstanding at the end of year. The latter is a stock measure of size, as compared to a flow, and provides a better basis for comparison with the size of lending under the MFI model, or with bank lending to other categories of borrowers such as marginal farmers, since it standardizes for loan tenor. In an important study based on a survey of participating banks under the programme conducted by GTZ / NABARD in 2005. These ratios had been the subject of conjecture until now.

## ADVANTAGES OF MICROFINANCE

Microfinance is argued to have economic, social and humanitarian advantages. This study tends to focus on the economic implications of microfinance, but also outlines social and

humanitarian aspects of microfinance in order to better understand the topic. Many researchers argue that microfinance creates access to three types of capital. First, it gives access to productive capital through microcredit. Second, it gives access to human capital through vocational training and education. And third, social capital built through creating local organization building, promoting democratic systems and fortifying human rights. These endowments together are argued to enable people to move out of poverty. Although it is nearly impossible to measure, increasing material capital strengthens the sense of dignity of poor people and contributes to motivating poor people to participate in the society. With a loan and a source of income people are argued to be able to improve the socioeconomic position of their family and to make plans beyond only the survival of the day. The existence of these conditions stimulates people to be actively involved in society. Participation in microfinance programs leads to a greater diversification of labour supply across seasons.

## CHALLENGES OF MICROFINANCE IN INDIA

The brief overview of the demand for micro-financial services suggests the huge challenges and the opportunities the Indian market presents. Protective financial services may be critical for poverty alleviation, but they do little for helping people out of poverty. Hence, promotional financial services are required, primarily for enhancing livelihood among poor people.
The institutional challenges in micro financing are three fold:

(i) How to support existing leading and social entrepreneurs and nurture new ones; at least one million SHG's will be require support;
(ii) How to ensure the SHG's remained autonomous and are not captured by political and bureaucratic interests pursuing votes or targets? Will the emerging movement of SHG's be any better at preventing this than previous movements, such as cooperatives?
(iii) How to support the SHG's movement so that it can go beyond financial service provision to support the development of a large number of livelihoods among SHG members? Some would argue, this is inappropriate for such small organizations. Other, would say it is essential given the livelihood India needs to generate, not the least for women?

## KEY ISSUES IN MICROFINANCE IN INDIA

**Loan Default :** Loan default is an issue that creates a problem in growth and expansion of the organization because around 73% loan default is identified in MFIs. Lack of understanding on the part of the clients, they also cannot correctly manage the loans given to them. As a result, they are not able to pay back the loan.

**Low Outreach :** In India, MFI outreach is very low. It is only 8% as compared to 65% in Bangladesh. Data show the great potential of MFIs in increasing their outreach and scale of operations. It has been observed that MF programmes focus a great deal of attention on women. It has been argued that women are better clients as they are more inclined to save than men, they borrow smaller amounts than men and their repayment performance is better than men. These characteristics of women clients constitute evidence in support of the inclination of MFIs to cater to the needs of women. Women may be better and more reliable clients, but in order to increase their outreach MFIs cannot ignore men as clients.

**High Interest Rate :** MFIs are charging very high interest rates, which the poor find difficult to pay. It has been argued that MFIs are private entities and hence need to be financially sustainable. They do not receive any subsidized credit for their lending activities and that is why they need to recover their operational costs from borrowers. In the process, the basic reason for their existence-and their primary objective-is being lost. It is important that these NGOs should be willing to operate at narrow margins and to bear a low effective interest rate so that they can maintain a balance between their dual objectives of commercial viability and serving the poor.

**Negligence of Urban Poor :** It has been noted that MFIs pay more attention to rural areas and largely neglect the urban poor. Out of more than 800 MFIs across India, only six are currently focusing their attention on the urban poor. However, the population of the urban poor is quite large, amounting to more than 100 million. With increasing urbanization, this number is expected to rise rapidly in the coming years. In this situation, MFIs need to pay equal attention to the urban poor because they too need financial assistance for various activities.

**Client Retention :** Client retention is an issue that creates a problem in growing the MFIs. There is about 28% client retention in the MFIs. This occurs because people are not properly informed and educated about services and products provided by the institutions more over the current client have higher default rate.

**Low Education Level :** The level of education of the clients is low, so it creates a problem in the growth and expansion of the organization because its percentage is around 70% in MFIs. Target population of MFIs is people of rural areas and they have no or less education level. As the percentage of people who have very less education.

**Language Barrier :** Language barrier makes communication with the clients (verbal and written) is an issue that creates a problem in growth and expansion of the organization because around 54% language barrier has been identified in MFIs. As the education level of clients is low so it is difficult to communicate with them. For this reason it is also difficult for the MFIs employees to make the clients to understand the policy and related details.

**Late Payments :** Late payments are an issue that creates a problem in growth and expansion of the organization because late payments are around 70% in MFIs. This usually occurs because clients are uneducated and they don’t know how to manage their debt. They are unaware of the fact that late payment increases their loan payments.

**Geographic Factors :** Around 60% of MFIs agrees that the Geographic factors make it difficult to communicate with clients of far-flung areas which create a problem in growth and expansion of the organization. MFIs are basically aimed to facilitate the BPL population of the country but due to lack of infrastructure in those areas it becomes difficult to reach them.

**Debt Management :** Clients are uneducated about debt management 70% of the clients in MFIs are unaware of the fact that how to manage their debt. Because of the lack of education and understanding on the part of the clients, they also cannot correctly manage the loans given to them. So for this reason debt management creates a problem in growth and expansion of the organization.

**High Transaction Cost :** High transaction cost is a big challenge for microfinance institution. The volume of transactions is very small, whereas the fixed cost of those transactions is very high. It cannot vary with the size of the loan. The higher a producer's fixed costs in the proportion of his total cost, the element of risk increases in the same proportion. Moreover, if the demand for the product falls or the marginal costs increases, it becomes very difficult to adjust the cost by cutting output. This cut will reduce revenue out of which he has to pay principal amount as well as interest on the loan. This needs to be rationalized.

**Lack of access to Funding :** Another factor contributing to the lack of growth in MFIs is that requisite financial support has not been provided to MFIs by concerned agencies. Around 68% of MFIs response was in favour of that government and SBP don't support them to meet the funds requirement as MFIs cannot alone remove the poverty from the country.

**Loan Collection Method :** Loan Collection Method is found an issue that creates a problem in growing the organization. Around 55% of MFIs agrees that due to weak law and legislation they are not able to make their loan collection system as effective as they want to do so.

**Fraud :** Fraud is an issue that creates a problem in growth and expansion of the organization because its percentage is around 67% in MFIs. Mismanagement of loans on the part of the clients creates the problem of fraud and financial embezzlement on the part of clients.