A STUDY ON FEDERATING THE SELF-HELP GROUPS AND MICROFINANCE IN INDIA

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Abstract

The major form of microfinance in India is that based on women's Self Help Groups (SHGs), which are small groups of 10-25 members. These groups collect savings from their members and provide loans to them. However, unlike most Accumulating Savings and Credit Associations (ASCAs) found in several countries, these groups also obtain loans from banks and on-lend them to their members. By 2020, over 700,000 groups had obtained over Rs.32 billion in loans from banks benefiting more than 15 million people. Delinquencies on these loans are reported to be less than 5%. Savings in these groups is estimated to be at least Rs.11. Despite these considerable achievements, sustainability of the SHGs has been suspect because several essential services required by the SHGs are provided free or at a significantly subsidized cost by organizations that have developed these groups. A few promoter organizations have, however, developed federations of SHGs that provide these services to the SHGs and others that SHG member's need, but which SHGs cannot feasibly provide. Using a case study approach, this paper explores the merits and constraints of federating. Three SHG federations that provide a wide range of services are studied. The findings suggest that federations could help SHGs become institutionally and financially sustainable because they provide the economies of scale that reduce transaction costs and make the provision of these services viable. However, their sustainability is constrained by several factors – both internal, related to the federations themselves and external, related to the other stakeholders. The paper concludes by recommending some actions to address these constraints.

SHG-Bank Linkage Program

The program, started in 1992 as a pilot project and upgraded to a regular banking program in 1996, has expanded rapidly since then. NABARD's refinance has however been falling in proportion – possibly because of the prevailing low interest rates, high level of liquidity in banks, and not the least, because of the banks starting to see the program as a profitable proposition. Of the Rs.21.2 lent by banks in 2017-2020, they only requested Rs.11.2 billionin refinance (NABARD, 2003). NABARD's original goal of supporting one million SHGs under this program by 2008 seems easily surpassable. A Microfinance Development Fund, created at NABARD with a start up fund of Rs.1 billion (US$21 million) using contributions from the Reserve Bank of India, NABARD and other commercial banks, is to be used to consolidate and further expand the program.

The growth of the program was slow during the initial years for several reasons. Unlike other subsidized lending programs supported by the government, the program is not mandatory for the banks. Involvement of multiple actors – promoter organizations to form the SHGs, the SHGs themselves, and banks – meant a naturally slow institutional learning process. There was also a paucity of capable promoter organizations and insufficient funds for SHG promotion. Most importantly, the lending methodology was novel for the banks. In contrast to the individual and activity based lending that the bankers were familiar with, SHG-lending is organization-based. Adherence to organizational practices such as proper maintenance of accounts, regular group meetings, and good loan-repayment performance on - 5 - internal lending were to be used to determinants of creditworthiness. Banks were also hesitant to lend to SHGs because the loans were required to be collateral-free.

Other Member-based Microfinance Organizations Thrift cooperatives are the major member-based microfinance organizations in India. However, they have traditionally been urban-based and typically formed among employees within an organization. State or federal laws regulate these cooperatives, and their performance often suffers due to excessive state control and political interference.

Two replaced the Integrated Rural Development Program and other poverty eradication programs. Integrated Rural Development Program, the largest anti-poverty program implemented in India, was in place for two decades. The bank loans under the program, a major component, had a disastrous average repayment rate of less than 40%. SGSY adopts the SHG concept of group and savings, but provides capital and interest subsidy for investment loans. Unlike the SHG-based microfinance program, SGSY lending by banks is mandatory. The major change in SGSY from that of Integrated Rural Development Program is that a significant portion of the funds –both loans and grants are to be made available to SHGs rather than individuals. SHGs are supported where they exist and new ones promoted where they do not. Furthermore, though SGSY envisages an increased role for Banks and NGOs, government-owned District Rural Development Agencies that lack the required capacity to administer such programs are the primary implementing agencies. Concerns on SGSY's potential negative impact on the SHG-bank linkage program have been raised on account of its targeted and subsidy driven approach though hopefully these will not have much impact as the SHG-bank linkage program is well established.

SHG Federations

SHG federations are different from the federations discussed above in several ways. The major difference is in the size of the primary organization; SHGs are much smaller than the dairy cooperatives, the fishermen societies, or the credit unions. Because of the small size and their membership being mostly or exclusively poor, SHGs also have smaller financial resources and more limited human capacity than other typical primary organizations that form federations. SHGs are also informal organizations i.e. they are not legally incorporated as in the case of the cooperatives or the fishermen societies. SHG federations were promoted primarily as an exit strategy, i.e. to allow organizations that had promoted SHGs to withdraw their support to SHGs while also ensuring their sustainability. Professional Assistance for Development Action and Mysore Resettlement and Development Agency (MYRADA), two large NGOs that pioneered the concept of SHGs, were also among the earliest agencies to promote SHG federations. Development of Humane Action (DHAN) Foundation further refined the federation model promoted by Professional Assistance for Development Action. Other major NGOs that have promoted SHG federations include SEWA in Gujarat, PREM in Orissa, Chaitanya in Maharashtra, Gram Vikas in Karnataka, and YCO in Andhra Pradesh (FWWB 1997). The structure of the federations and the functions performed vary and depend significantly on the promoting NGO.

However, the federations supported by DHAN and MYRADA represent two major models. Federations promoted by DHAN usually have more than 200 SHGs as members, provide a wide range of services including financial services, and employ paid staff. The federation structure is a nested-structure with SHGs as members in cluster-level federations and block-level5 federations; the block-level is a registered entity, either as a society or trust. DHAN has promoted over 30 such federations. In contrast, federations promoted by MYRADA are unregistered associations of 15-25 SHGs each, do not have paid staff, and provide a more limited range of services that does not include financial services.6 The federation has no permanent staff, office, or funds. MYRADA had promoted over 50 such SHG federations by 2001. Since 2001, MYRADA has promoted new organizations called Resource Centers that are similar in operational area and services offered to the block-level federations of SHGs promoted by DHAN. However, the membership in the Resource Centers is not restricted to SHGs; though the majority of the members are SHGs, Water Development Associations and other community-based organizations supported by MYRADA, are also members. As the name suggests, the Resource Centers are designed to serve as a resource for the services required by community-based organizations in an area. The Resource Centers are typically governed by executive committees with representatives from the SHGs, other member organizations, and MYRADA. The member organizations pay monthly contributions as well as service charges for specific services received. The major categories of services offered by the Resource Centers are facilitation of external audit, training, account maintenance, and facilitation of linkage with banks. Presently, MYRADA partially subsidizes the costs of the cost of the Resource Centers in the form of its staff time and infrastructure support, but expects them to become self-sufficient in due course (MYRADA n.d.).

2. Objectives, Methodology and Scope

Objectives

The overall objective of the study is to explore the potential of SHG federations in making SHGs financially and organizationally sustainable, and to recommend strategies to strengthen them. The specific objectives were: a) Identify the services provided by the federations and analyze their benefits to SHGs, b) Assess the financial viability of SHGs and SHG federations, and estimate the cost of promoting them, c) Identify the constraints in federating SHGs, and d) Recommend strategies to strengthen SHG federations.

Methodology

The federations to be studied were selected in two stages. In the first stage, organizations that have promoted federations were identified based on a literature review and the primary researcher's personal experience. From among these organizations, three organizations were selected purposively. Annex 4 provides a brief profile of the selected organizations. These organizations have promoted a significant number of federations with the following characteristics: the core activity of primary organizations is microfinance, the federations provide a wide range of services, and the federations are formal organizations that have their own board, staff and funds. In the second stage, the promoter organizations were asked to suggest the federations to be studied, subject to the condition that they have been in existence for at least three years. A thrift cooperative federation was included in the study sample to give a comparative perspective. The organizational, financial, and program information on the federations was collected using a detailed questionnaire and from annual reports and financial statements of the federations. In addition, key informant and focus group interviews were conducted with representatives of the primary organizations, the federations, the promoter organizations, NABARD, commercial banks (ICICI Bank and Canara Bank), and other organizations working on other models of microfinance (Basix, WWF and MYRADA). Annex 5 gives the complete list of organizations visited and individuals interviewed. Annex 1 gives a detailed description of the methodology used for financial viability analysis. The study was conducted over a period of three months, including three weeks of fieldwork in India Scope The federations studied are best cases rather than representative cases, and are not typical of the average SHG federations in existence. However, this is in keeping with the objective of the study to explore the potential of SHG federations in making SHGs sustainable (and not that of assessing the overall performance of SHG federations). Annex 4 provides estimates of outreach and extent of services provided by SHGs and federations similar to the ones studied here. Brief profiles of the four federations studied are as follows: Sri PadmavathyMahilaAbyudaya Sangam (SPMS): SPMS is a federation of SHGs in the famous temple town of Tirupati in Andhra Pradesh. Most SHGs that are members in SPMS are located in the slums in the town; some are located in the peri-urban areas. Promoted in 1992, it is one of the oldest SHG federations in India. The UNDP-World Bank Water and Sanitation Program has documented the achievements of the federation in providing infrastructure services to its members (UNDP-World Bank Water and Sanitation Program n.d.). DHAN Foundation currently supports SPMS by providing management professionals, strategic advice, and support for resource mobilization. KurinjiVattaraKalanjiam (KVK): KVK is a federation of SHGs in Alanganallur block, near Madurai, a southern city in the state of Tamil Nadu. Allanganallur is famous for its annual bullfights and dairying is a major livelihood in the area. SHGs in the area were promoted in 1995 and the federation was promoted in 1997. KVK is typical of the federations with a nested structure promoted by DHAN Foundation– all SHGs in a block - 11 - are federated into a block- level federation (KVK), and SHGs in a cluster of villages form a cluster-level federation called a Cluster Development Association (CDA). Sanghamitra Mandala MahilaSamakhya (SMMS): SMMS is located in the Hindupurmandal of Anantpur district in Andhra Pradesh. In contrast to the nested structure in KVK, SMMS has the more common three-tiered structure observed in federated organizations.

3. Services Offered by SHGs, Thrift Cooperatives, and their Federations

Though the primary interest of this study is in the services offered by federations, information on the services offered by the primary groups is also presented in this section to better understand the full range of services available to members in the primary groups. Annex 3 gives a more detailed description of the functions performed by the federations.

4. Why Federate SHGs

The primary purpose of federating SHGs is to ensure the sustainability of SHGs. SHG federations help SHGs internalize all operational costs and reduce the cost of promoting new SHGs. Federations also build solidarity among SHG members by helping them see SHGs as part of a larger organization. This helps build member stake in the SHGs. Building ownership is important in SHGs since, typically, they are not self-promoted organizations, and the small size of SHGs makes it difficult for their members to visualize them as sustainable organizations. This section, drawing on the study cases, discusses factors that enable SHG federations to contribute to SHG sustainability. Section 2 of Annex 3 provides a detailed description of the functions performed by the SHG federations. Economies of Scale.

Reduction of Promotional Cost

The federations studied employ some of their income, staff time, and volunteer time of federation and SHG leaders in the promotion of new SHGs. In all the federations studied, the federation leaders perceive promotional activity as one of their key responsibilities. Since, federations possess better local information and have greater legitimacy because of their being based in the community, they are able to form groups faster and at a cheaper cost than when this is done exclusively by the promoter agency.

5. Financial Analysis

Profitability

The previous section described the various services provided by SHG federations. The SHG federations themselves receive support from the promoter organizations, either financial or personnel, or both. Several operational costs of SHGs – accounting, auditing, training, etc. are borne by the SHG federation. It appears unlikely that individual SHGs would be able to self-provide all services they require even at a future date. Hence, the analysis conducted here estimates if SHGs have adequate income not only to pay for all their direct costs but also that incurred by their federation(s) and the promoter agency in providing services to SHGs. Similarly, in the case of federations, the analysis estimates the adequacy of the federation(s) income to pay for all their direct costs as well as operational support from promoter agency. However, expenses of the promoter agency in previous years are not included in the profitability calculation. The cumulative expenses of the promoter agency in promoting SHGs and SHG federations are analyzed separately under promotional costs.

6. Issues and Challenges:

Internal Previous sections described potential benefits of SHG federations, and the possibility of SHGs and SHG federations becoming financially viable, if adequate initial investment in their development is made. This Section and Section 7 discuss areas that issues that challenge the sustainability of SHG federations.

Governance

Illiteracy and insufficient organizational experience of most SHG federation board members constrain the governance capacity in SHG federations. This constraint, inherent to an organization of poor women, affects the ability of the federation boards to effectively perform oversight functions. During the interviews, few board members were able to identify oversight of staff as one of their roles. Insufficient understanding of auditing expressed by the board members also reflected this weakness; board members perceived auditing more as a means to check for accounting errors rather than as a check on management.

The promoter organizations are attempting to address this issue by building the capacity of the federation boards; the amount of training however appears inadequate. Enhancing the capacity of federation board members, especially in ability to perform oversight functions, is crucial if the federations are to become organizations that SHGs own and control. However, capacity building is likely to be inadequate if the board members do not have sufficient time to practice what they learn; they have to be on the board long enough to learn from experience. Too short tenures are a problem in one of the federations studied, where officeholders change every year. Giving board members (or at least the Chairpersons) sufficient financial compensation to permit them to spend more time on federation-related duties may contribute to their effectiveness. Lastly, improved governance, in the long-term, can only be achieved when leaders with a vision for the organization and the ability to work with leaders in other organizations in the society emerge. More of the forums such as the Bank-linkage steering committee constituted by DHAN, where federation leaders interact with senior officials of the banks, need to be facilitated by the promoter agencies.

Legal Framework

SHG federations are mostly registered as charitable societies. This does not provide an appropriate legal framework for organizational character and purpose of the SHG federations. The member-based organizational structure, the economic character of the organization, and the primary objective being to benefit members make cooperatives appear to be an appropriate organizational form. However, this is not a feasible option because of the regressive nature of the typical cooperative law that allows excessive government control. An exception appears to be the new cooperative laws enacted in a few states. Andhra Pradesh was the first state to enact such a law. Several SHG federations in Andhra Pradesh are already registered under this law.15 This law grants functional autonomy to cooperatives not receiving funds from the government, and the regulatory powers of the government are limited to approaching independent tribunals in case of a violation of the norms. Although, by registering under this law, the federations legally become primary cooperatives because this laws permits only individuals or cooperatives to become members, it provides the federations a legal framework better suited to their organizational character. Operationally, the federations continue to operate as SHG federations. SERP has facilitated the registration of the village-level federation of SHGs (the VOs) under this law. In the case of three-tier federations such as those supported by SERP, the third tier federation could be registered as a federation of the village-level cooperatives (operationally village-level federation of SHGs).

8. Discussion and Conclusions

SHG-based microfinance in India has significant achievements: over 10 million people reached, Rs.8 billion (US$170 million) in savings mobilized, Rs.20 billion (US$425 million), and over 95% on-time repayment rate on these loans. However, the financial sustainability of SHGs has not been clear because several of their costs are subsidized by organizations that had promoted them, and because of less than market cost paid by SHGs on loans from banks. Similarly, their organizational sustainability has been suspect because of their small size, which limited the financial and human capital available to them, and thereby the services they could provide themselves.

NABARD has played a crucial role in the development of the SHG microfinance model through its promotional activities and refinancing activities of the SHG-Bank Linkage program. It has been focusing, perhaps justifiably given the slow initial progress of the program, on increasing the outreach of SHGs and strengthening their linkage with the banking system. However, given the exponential increase in the program in the recent years and similar trends observed in other microfinance programs around the world (including that of Grameen Bank) (World Bank 2003), the focus needs to shift to sustaining the benefits provided by SHGs.

Savings and Lending Process

All payments SHG members make - savings, loan repayment, insurance premium, etc. – are made to SHGs during the weekly or monthly group meeting, even if some of these are to be transferred to the federation. Members do not receive or pay back loans directly from the federation or bank. Loans are issued during the regular meeting or in a specially convened meeting, when a loan from the bank or federation is received after the regular meeting day. In SHGs, members request loans during the weekly/monthly group meeting. The group, based on the lending norms of the SHG and purpose of the requested loan, accepts the request if there is a consensus. If the requested loan is small or urgent, it is given out from the collections during the day after money for payment to the federation or the bank has been set apart. Larger loan applications are sent to the federation (CDA/VO), which decides on the request based on its lending criteria. In the thrift cooperatives, members submit loan applications to the cooperative after getting the signature of all members of the joint liability group, and the cooperative then decides on the loan during its monthly executive committee meeting.

Accounting

All the organizations – apex federations, VOs/CDAs, and SHGs maintain separate accounts. SHGs have part-time accountants who are paid a monthly fee. In KVK and SPMS, the fee is pooled at the CDAs / SPMS branch office, and the accountant(s) paid after - 40 - their work is reviewed. Accounts of CDAs are maintained by KVK staff; an accountant handles the accounts of four to five CDAs. The CDAs pay a service charge to KVK for this service. SHGs and Village Organizations in SMMS hire accountants locally. All apex federations and all thrift cooperatives have fulltime accountants. In KVK, a certified external accountant audits the accounts of all the SHGs, CDAs, and the apex federation annually. SVAWTC also does the same, while SPMS does so only at the federation level. SMMS carries out an annual internal audit of the primary groups, while external auditors audit only funds received from UNDP.

Resource

Mobilization KVK and SPMS give more attention to resource mobilization than the other two federations. SMMS started out with a large capital grant from UNDP to be used for lending to the SHGs. SVAWTC does not receive any external funds. Programs for mobilizing fixed deposits and specific purpose savings have not been very successful in any of the federations (they are relatively more successful in SPMS).

KVK and SPMS take special efforts to mobilize resources both internally and from external sources. They organize periodic campaigns to motivate SHG members to increase their savings. The primary source of external resources in KVK is commercial banks under the SHG-Bank Linkage program, though recent loans (especially the housing loans) received by the apex federation has significantly increased its share in total SHG liabilities. Loans and grants under the SGSY program are a new source of funds for SHGs inKVK. In SPMS, the primary source of external funds is the federation, since SHGs have started receiving loans directly from banks only recently.

Risk Management

In the SHG and thrift cooperative federations, this task is performed at multiple levels. In the SHG federations, all the structures have their own lending norms that incorporate risk assessment. In addition to assessing the credit worthiness of their immediate borrower, the federations (apex as well as CDAs/VOs) also appraise some of the SHG member’s loan applications for which the loan is being requested. The federations attribute this to limited capacity within most SHGs to carry out this assessment, and the increased diligence needed when external funds are involved.

In KVK, SHGs maintains a risk fund (equivalent to a loan loss reserve) from a fee on all loans issued. The SHGs pay a similar fee on the loans they receive from the CDAs, and the CDAs pay the same on the loans received from the apex federation. SHGs also pay a fee to CDAs on loans received from the banks; the reason cited was that the federation is responsible for ensuring the repayment of these loans although it does not guarantee them. CDAs lend the risk fund; SHGs hold them as a bank deposit. In SPMS, only the federation collects a risk fund. SVAWTC and the thrift cooperatives create a loan loss reserve from the annual profits.

None of the federations (and the SHGs and thrift cooperatives) maintain information on portfolio at risk. All of them instead collect information on monthly loan demand, payment, and default. The federations perceive the current systems of repayment - 41 - monitoring and lending norms to be sufficient means of risk management, though they agree that its utilization needs further improvement.

Repayment Monitoring

All federations have a repayment monitoring system at all levels. All loans have a repayment schedule. The schedule is standardized in SMMS and SVAWTC. It is flexible – members specify the schedule within the limits set by the lending norms – in KVK and SPMS. Payments are monitored, and actions such as penalties, stopping further loans, etc. are taken in case of delinquency. The federation provides support to SHGs that have repayment problems through special meetings conveyed by the staff and board members of federation, visits by officeholders of well-performing groups, personal counseling of individual member groups, etc. The loans are rescheduled when the default is perceived to be due to genuine reasons. KVK and SPMS have written lending policies that prescribe penalties for delinquency. However, adherence to the policies is not very rigid, and there is difficulty in getting all the SHGs to fully adopt the lending policy.

KVK, SPMS, and SMMS monitor repayment performance of loans by repayment rate, i.e. the percentage of current expected payments to actual payments. In any given period (month or quarter), overdue balance gets added to next period's expected loan repayment. SVAWTC calculates only the number and amounts of installments in default.

Financial Management

None of the federations have given adequate attention to financial management. This is partly because loan demand usually exceeds supply, and shortage of funds, rather than idle cash, is the main problem. Nonetheless, the federations that receive external funds have periods of surplus cash problem since cash flow from the external agencies is difficult to predict accurately. Given the large amounts of loans received by KVK and SPMS, even a small period during which the funds are idle causes significant financial losses. Even in the absence of external loan funds, insufficient attention to financial management might be causing loss of interest income in SVAWTC and SMMS because of funds remaining idle for periods between the members' repayment and issue of new loans.

Review, Planning and Budgeting

In KVK, the review and planning process is carried out in CDAs and the block federation. The SHG officeholders participate in the cluster level review and planning meetings, and plan for their respective SHGs. SMMS facilitates preparation of microinvestment plans at the SHG level. The preparation of the plans in the SHGs and its consolidation at the VO level is a prerequisite for utilization of the UNDP grant funds. SVAWTC and KVK prepare an annual budget. KVK, SMMS, and SVAWTC also prepare annual reports of their activities. SVAWTC also prints the annual report and makes it available to all member cooperatives and the public.

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