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Road to Sustainable SHG-Bank Linkage Programme: Formulating Strategies for Managing Credit Risk with Respect to Rural Bengal

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Abstract

To alleviate poverty and unemployment in villages and to include rural India under a structured financial system, the government, through institutions like National Bank for Agriculture and Rural Development, has been trying to promote Self Help Groups (SHGs) by financing their projects. These rural SHGs have been financed mostly by the semi-urban bank branches, rural bank branches, Regional Rural Banks, microfinance institutions and regional co-operative banks. However, the financial institutions are burdened with huge losses due to non-repayment of loans availed by the SHGs which leads to accumulation of Non-performing Assets. Moreover, the bank managers are held responsible in case of such default, their superannuation benefits being either curtailed or delayed. This has made them all the more reluctant to further finance the SHGs. This situation adversely affects the birth of new SHGs and the existing groups are forced to embrace local moneylenders at an exorbitant rate of interest. Hence, the government's effort to financially reach out to the poor through SHGs seems to be a rather difficult task.

This article focuses on formulation of strategies for managing credit risk of SHG as an effort to make the SHG-Bank linkage programme sustainable. It is framed from the viewpoint of the banks, concentrating on their approach towards financing SHG projects.

Keywords

SHG-Bank Linkage, Credit-risk Management, Regional Rural Banks, Non-performing Assets

> ***The government proposed to extend the provision of bank loan for women Self Help Groups at 4 per cent in another 100 districts under Aajeevika, the National Rural Livelihood Mission (NRLM). Under this mission, Women SHGs are provided bank loans at 4 per cent on prompt repayment in 150 districts and at 7 per cent in all other districts.***
>
> Shri Arun Jaitley, Union Finance Minister, Republic of India

Self Help Groups (SHGs) catalyze the Government's objective of financial inclusion throughout the country. In order to promote such groups and their activities, SHG-Bank linkage programme was established as one of the many initiatives in 1990 under the sponsorship of NABARD. Subsidies were given to the nationalized banks operating in rural India to finance and promote the SHGs. The local Non-Governmental Organizations (NGOs) and the blocks of the villages were supported financially by NABARD for promoting SHGs. However, most of these funds were either not properly channelized or their utilization was not monitored, which resulted in the accumulation of NPAs with the banks. With respect to the SHGs formed under the centrally sponsored scheme, Swarnajayanti Gram Swarozgar Yojana (SGSY), the percentage of NPA accounts stood at 5 per cent by the end of 2012 (Bankers Institute of Rural Development, 2012). Considering the high growth of NPAs over the years, Government of India,

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with effect from 1 April 2013, replaced SGSY with National Rural Livelihood Mission (NRLM)—'Ajeevika', promoting the Women Self Help Groups (WSHGs).

In the light of the above scenario, the article intends to concentrate on the following issues:

- Would the introduction of a new scheme without reducing the previous NPAs increase further burden on banks?
- Whether Government's new initiatives improve the SHG-Bank linkage?
- Formulation of the credit-risk management strategies based on the findings from the survey has been conducted with the selective branches of the major banks operating in the six districts (Bankura, Birbhum, Jalpaiguri, Malda, Purba Medinipur and Purulia) of rural Bengal, identified as 'backward' by NABARD.

Establishment and Financing of SHGs

Pioneered by Muhammad Yunus, 'Grameen Bank', the successful model in Bangladesh, was adapted to the Indian context for poverty alleviation, eradication of unemployment and empowerment of women. The government took the initiative of spreading such powerful instruments through promotion of SHGs, especially among underprivileged women. During the post liberalization phases, the real turning point in 'SHG movement' was NABARD's decision to promote SHGs on a large scale.

In 1993, the Reserve Bank of India (RBI) facilitated banking services through the opening of SHG savings accounts with the banks, interlinking banks and SHGs.

In India, three different models of SHG-Bank linkage had emerged. They were:

- Banks were allowed to form and finance the SHGs.
- SHGs were formed by NGOs and other agencies but financed by banks.
- Banks finance SHGs with NGOs and other agencies as financial intermediaries.

The second model is the most popular one. Almost three-fourths of all the SHGs come under this model. Only 20 per cent of the SHGs are covered under the first and 8 per cent are under the third model (National Commission for Women, 2012).

SHGs mostly find the source for finance in semi-urban branches of the nationalized commercial banks, RRBs (backed by nationalized commercial banks) and micro-finance organizations. The government grants subsidy for the formation of such SHGs, channelizing the funds through the commercial banks or RRBs.

Certain policies are, however, in force for such banks and RRBs. These include activities like the implementation of Financial Information Network and Operations Ltd. (FINO), enabling technology solutions with a mission of enabling financial inclusion to all unbanked and under-banked masses located in informal rural areas. It includes facilities like:

1. No frills savings accounts,
2. Insurance: Health, Life and Accidental,
3. Remittance services,
4. Utility bill payment services,
5. Microloans, etc.

Generally, the branch managers have a liaison with the NGOs promoting such SHGs. The NGOs usually support the SHGs in their product promotion and improving marketability of products, resulting in prompt repayment of loans. These NGOs act as a mediator in circulating the flow of funds among the SHGs and Banks. The simple circular flow diagram below (Figure 1) helps understand how the financing of SHGs are usually done. However, an interruption in the circular flow leads to the disruption in the flow of funds, leading to non-repayment of the loan amount to the financial institution.

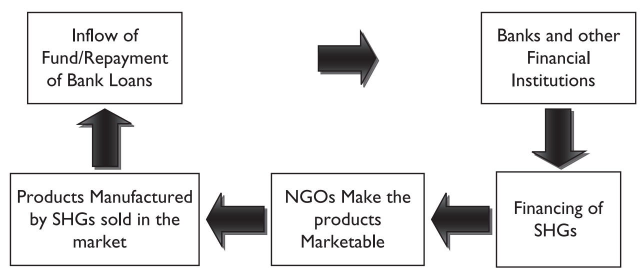

Figure 1. Flow of Funds: Provision of Loans to Repayment of loans

Source: Author's own.

West Bengal, falling within the list of the priority states in India in implementation of SHG programme, has tried to implement it with some special initiatives:

- Nadia District Central Cooperative Bank (DCCB)—Covering risk and securing lives of SHG members:

  This initiative involves an insurance policy covering the lives of the SHG members on payment of ₹ 24 per year towards membership of the Fund. This would cover their life by extending financial assistance upto ₹ 30,000 in the event of the death or disability of the member/her spouse and also for meeting the expenses of higher education of the members' girl children. Such an initiative led to enrolment of more than 35,000 members for the fund. Moreover, the bank aimed at covering over 18,000 SHGs in the entire district.

- Transition in Purulia District through 'Muktidhara':
  Such a project was launched in the Maoist dominated district of Purulia, with the ultimate objective of ensuring at least ₹ 3,000 per month to the members of SHGs by providing them two or more livelihood options locally, and also by converging other schemes and programmes implemented by the State Government for the welfare of the poor. The government issued guidelines to banks to support the project with adequate financing to SHGs with a minimum credit limit of ₹ 1,00,000, relaxing the rigid norms of financing to four times of the corpus of SHGs. The project aims at promoting community structures and creation of internal social capital for sustainability of the SHGs. Monitoring will be done at state and district level jointly by the State Government and NABARD. The successful practices under 'Muktidhara' will be upscale in the state through the State Livelihood Mission (SLM) 'Anandadhara'. This is a unique convergence model of the State Department, SLM and NABARD in order to facilitate sustainable livelihoods through local community resource persons.

Unfortunately, the state has not been successful enough in this regard. The overall position of the state of West Bengal has been shown in Exhibit I with respect to SHGs till 2013 as follows:

Exhibit I
Position of SHG Financing in West Bengal (2010–2013)

Potential Rural households to be covered	103.96 lakh		
Rural households covered (SHG: Savings linked) [No. of SHGs x 13 members/SHG]	76.29 lakh		
Average savings/SHG (₹)	12388 National Average : 11230 Highest Priority State : West Bengal : 12388		
	2010–11	2011–12	2012–13
Loans Issued to no. of SHGs (Lakhs)	1.32	0.99	0.95
Loans issued (₹ in crore)	575.90	551.37	514.15
Loans outstanding (₹ in crore)	1499.25	1570.03	2424.47
Gross NPA (₹ in crore)	34.20	48.90	141.98
No. of WSHG districts	6		

Source: Compiled from 'Status of microfinance in India', NABARD, 2013–14.

The above figures suggest that though the issue of loans has increased over a considerable period of time, there has been an increase in the outstanding loans, resulting in huge accumulation of Gross NPAs. A survey conducted with the manager of a semi-urban branch of United Bank of India revealed that many SHGs procure several loans from different organizations showing the same project. This money is not invested, but spent for consumption purposes. In the absence of any investment, the circular flow of income is interrupted leading to the accumulation of a huge amount of bad loans. It has also been pointed out that the NGOs play an important role as a facilitator, who has a virtual interest on the issue of such loans.

The government had introduced the WSHG plan in 2013 without recovering the accumulated bad loans. New schemes may not succeed without looking into the loopholes of the previous schemes and taking necessary corrective steps. Hence, formulating a proper strategy to manage the credit risk arising out of SHG financing is the call of the day.

Managing Credit Risk in SHG Financing

The Basel Accord for Banking Supervision (Basel I[1] and Basel II[2]), an effective tool for managing credit risk, has not been strictly made mandatory by the RBI in case of the RRBs, microfinance organizations and cooperative banks. Hence, managing credit risk is a formidable challenge under the situation when they are exposed to high risk. As the risk management for such institutions lies at the branch level, the risk on lending is attributed largely upon the branch managers. The loans are being granted to the SHGs based on their accumulated deposits with the bank without any collateral security. In the event of any default, banks do not have any asset to attach and recover their debt. Branch managers are liable for lending risks and often held responsible for any defaults in loan repayment. Penalizing the managers for SHG's default generally affects their retirement benefits (provident fund, gratuity, etc.). This potential future threat holds back the managers and they

Exhibit II
Percentage of NPA to Loan Outstanding for SHGs (2010–2013)

Agencies	2010–11	2011–12	2012–13
Commercial Banks (Public Sector)	4.76	6.48	8.39
Commercial Banks (Private Sector)	10.10	5.30	3.69
RRBs	3.67	4.95	4.10
Co-operative Banks	7.04	6.84	8.13

Source: Compiled by the authors from 'Status of microfinance in India—2013–14' issued by NABARD.

Exhibit III
Loan Outstanding for SHGs with Respect to West Bengal (2012–2013)

	Public Sector Commercial Banks	Private Sector Commercial Banks	Regional Rural Banks	Cooperative Banks	Total
Loan Amount Outstanding against SHGs (lakhs)	105006.90	5.81	117470.81	19963.49	242447.01
Amount of Gross NPAs against SHGs (lakhs)	7993.48	Nil	4796.4	1408.22	14198.10
Percentage of NPA to loan outstanding	7.61	0	4.08	7.05	5.86

Source: Compiled by the authors from 'Status of microfinance in India—2013–14' issued by NABARD.

either do not entertain the request or deny the loan on some or other grounds. Therefore, on many occasions, SHG initiatives are not financed and they become inoperative. In case such SHGs which later become bad are financed, different banks adopt different approaches towards risk management.

Irrespective of using such risk management policy, the NPA figures have increased to a huge percentage and became a noticeable figure in the bank Balance Sheet (Exhibit II & III).

A survey conducted in the state of West Bengal among the bank managers of selected semi-urban nationalized public sector banks and RRBs identified the following reasons for the growth of NPA with respect to SHG financing (Annexure I):

- The major objective of promoters of the SHGs is sometimes to avail the subsidy from the government. After receiving the loans, most of the units lose their enthusiasm and the group dynamics disappear. Loan amount is spent outside the unit, often for consumption purposes, which does not necessarily generate cash flows. Therefore, possibilities of repayment are remote.
- Illiteracy has been another important drawback, as most of the members are not aware of the mode of repayment of the loan and their liability towards non-repayment of such loan. Every group has a leader who does the bank work and takes the loan, whereas the others just give their approval through their thumb impressions. There have been cases where the leaders have taken advantage of this situation and utilized the money for their consumption purposes.
- There is no monitoring of the utilization of loans issued either by the banks or the Panchayats. Shortage of staff has been identified as the major reason for lack of supervision of the work of SHGs and their group functioning, leading to the non-repayment of loans and accumulation of NPAs.
- Most of the products manufactured by SHGs are technologically outdated. There is a greater involvement of physical labour. The same products can be manufactured in less time by applying advanced technology. Therefore, it often appears that the product manufactured does not generate the expected return which a person otherwise would expect by involving such labour force. So, the members easily lose interest, leading to them moving out of the SHGs. This leads to non-repayment of loan, since in many cases, insufficient funds are generated to repay the loans.
- In most of the cases, loans were issued as per the directives of the locally influential persons, and often, such projects were fictitious. Naturally, such projects resulted in non-repayment adding to accumulation of NPA.
- The managers of the operative branches identified that in many cases, the SHG members utilize the

funds for their own benefit and often form a group which acts as a medium to receive the government subsidy, a part of which sometimes is paid to the Resource Persons (RP) as a commission for helping them in getting such subsidies. Once such subsidy is received, the group is broken which makes recovery difficult.

These are the major reasons for the weakening of the relationship between SHGs and banks. The worsened relationship between SHGs and banks can be repaired only by addressing this issue effectively. The initiative of the government to promote WSHG programme can prove to be effective with such strengthening of SHG-Bank linkage.

Strategies to Strengthen SHG-Bank Linkage

NABARD has issued some guidelines to make the local NGOs, who promote the SHGs, more responsible. NGOs will act as the facilitator for extending the NABARD assistance for formation of SHGs and create credit linkage between them and the banks as per guidelines. The commercial banks are given the responsibility to assist the SHG by channelizing the subsidies. The banks will finance the SHGs which are promoted to the area of operations by the NGOs.

A survey conducted over the NGOs has highlighted some of the steps taken by them in order to facilitate and promote the SHG-Bank linkage:

- The NGOs generally campaign in the local villages, assemble the women and finally help them in forming a SHG. After the formation, the SHG approaches the bank for finance. The most educated woman among the group members is selected as the member who will handle the banking transactions on behalf of the group.
- In order to make the group members financially literate and independent, the NGOs organize regular trainings by experts as part of financial literacy programmes.
- NGOs also promote better livelihood for the family members, especially the children of the SHG members through proper education upliftment.

For performing such activities, the banks pay a service charge of 5 per cent p.a. to the NGOs, based on the average monthly loan balances maintained in the account of SHGs. This service charge is expected to meet the administrative, transaction and risk costs of the NGOs. The NGOs are responsible for the follow-up and recovery of the loans from SHGs, and any overdue is deducted by the banks from the service charge payable to the NGOs. The banks pay the service charge to the NGOs each month after deducting outstanding loan amount of SHG, if any. The amount is credited into the account of the NGOs on its own, without seeking any documents and based purely on outstanding loans extended by the banks to the SHGs promoted by the NGOs and overdues, if any.

In order to minimize the risk arising out of such SHG financing, the following steps may be adopted by the banks:

1. Evaluating the viability of the projects undertaken by the SHGs and estimating the cash flows in the projects before issue of the loan.
2. After issuing loans to the SHGs, a proper monitoring of such loans is required time to time, with a regular performance report from the NGOs on the SHGs. On account of insufficient workforce, most of the banks find it difficult to monitor such loans effectively. In case of the RRBs, the scenario is worse with one field officer-in-charge of three RRB branches catering approximately 900 SHGs.
3. A valuable suggestion from the branch manager of a semi-urban branch of Canara Bank was to eliminate any middlemen like NGOs from the SHG-Bank linkage, and ensure that the bank finances the SHG directly. The field officer of a branch of State Bank of India revealed that SHGs which are directly administered by the banks have lesser amount of NPAs compared with others.
4. Facilitating the marketing of the products manufactured by SHGs. The NGOs and the Government are taking certain initiatives by organizing fairs and establishing retail outlets, but such initiatives are not frequent in nature. Banks are required to finance the marketing support initiatives as an effort to recover their own credits issued to SHGs.
5. Providing lifestyle developmental support to the rural residents by Corporate Social Responsibility (CSR) activities which would build confidence among the residents. Literacy programmes, which would make the people aware of the consequences of defaulting loans, can do a lot. Illiteracy does have a big hand in misappropriation of loans.
6. A generalized risk management policy cannot be implemented in case of RRBs. Hence, a recovery cell needs to be implemented at the branch level, which would monitor and facilitate easy recovery of the loans.

Road Ahead

Financing the SHGs has become a compulsion for the semi-urban and rural branches of the banks, especially after the launching of WSHG programme in 2013. According to our survey, the branches are being instructed to finance 40 per cent of their total corpus towards SHG financing at an interest rate of 7 per cent p.a.. Hence, structured risk management policies need to be implemented in order to reduce the increasing burden of NPAs out of SHG financing. As the Basel regulation cannot be implemented in this case, a proper risk management policy needs to be implemented, which will minimize the chances of the accounts becoming NPAs. Government has been implementing the new scheme without resolving the NPA problems accumulated from the past failures of SHGs lending. This puts more pressure on the banks as the bank managers are usually held responsible for accumulation of NPAs from the SHG lending. A few suggestions have been formulated in the article and these may be considered as a guideline which, if implemented, would restrict the SHG account to turn to NPA. The above policies are the outcome of the survey conducted with the branch managers of the semi-urban and rural branches, who are primarily dealing with the problems of NPA accumulated from SHG lending. The government initiation of financial inclusion through SHG lending can prove to be an effective weapon when a customized risk management policy can be effectively implemented with respect to such lending. The new financing policy of the government is an effort towards promoting the WSHGs through the NGOs which would help in building up a strong SHG-Bank relationship.

Annexure

Annexure I
Questionnaire Placed Before the Banks

1. What are the bases on which SHGs are financed by your bank?
2. How do you evaluate the viability of the projects undertaken by the SHGs before financing?
3. Do you monitor the work of SHGs after financing?
4. Are you satisfied with the role played by the NGOs in promoting SHG-Bank linkage?
5. Are the NGOs competent enough to play the role of an intermediary in recovering the bank finance?
6. What is the NPA ratio of your bank with respect to SHG financing?
7. Do you think that the products manufactured by SHGs are properly marketed?
8. Are you satisfied with the role of NGOs and State Government for making the product marketable?

Annexure II
Questionnaire Placed Before the NGOs

1. How are the NGOs interlinking government's efforts towards NRLM in restructuring of SHGs as a step towards financial inclusion?
2. What are the difficulties faced by the NGOs in forming the SHGs?
3. What are the difficulties faced by the NGOs in generating SHG-Bank linkage both from the bank and the SHG perspectives?
4. Do the products manufactured by the SHGs generate adequate amount of revenues to repay the bank loan? If yes, then why are the banks suffering from the non-repayment of such loans?
5. How do you think that the products manufactured by the SHGs can be made more marketable? Are you satisfied with the government's initiative in this case?

Notes

1. Basel I is the round of deliberations by central bankers from around the world, and in 1988, the Basel Committee on Banking Supervision (BCBS) in Basel, Switzerland, published a set of minimum capital requirements for banks. This is also known as the 1988 Basel Accord, and was enforced by law in the Group of Ten (G-10) countries in 1992. Basel I focused mainly on the credit risk by creating a bank asset classification system.
2. In June 2004, the Basel Committee issued the final version of the New Basel Accord (Basel II), a framework for risk management with three pillars: capital adequacy, supervisory review and market disclosure.

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