International Journal of Social Science and Economic Research

ISSN: 2455-8834

Volume: 04, Issue:03 "March 2019"

GROUP LENDING AND FINANCIAL INCLUSION: THE ROLE OF NABARD

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ABSTRACT

In this paper, we have tried to justify the rationale behind Joint Liability Group Lending (JLGL) over the Limited Liability Individual Lending (LLIL), and then we have tried to show the role of NABARD towards Financial Inclusion Initiative (FII) in India using JLGL programs. The group-lending programs have proven able to reach poor individuals, particularly women that have been difficult to reach through alternative approaches. NABARD's JLGL projects and SHG-BLPs have successfully led us to adopt microcredit programs, and thus play the lead roles to promote FII in India. NABARD takes pride in the fact that the Self Help Group - Bank Linkage Programme, which is the largest microfinance programme in the world, today touches nearly 11 crore households through more than 87 lakh SHGs with deposits of over Rs. 19500 crore and annual loan off take of more than Rs. 47000 crore and loan outstanding of over Rs. 75500 crore. Several initiatives are taken by NABARD to bring the poor into the fold of formal financial service providers, and serious attempts are made to achieve the Financial Inclusion (FI) goals. It is high time to promote the working of JLGs, SHG-BLPs and FII in a complimentary manner, synergizing the strengths, and ensuring effective banking footprints in remotest of hinterlands.

Keywords: Microcredit, Group Lending, Joint Liability, Social Sanction, Financial Inclusion.

JEL Classification: D 82, O 16.

1 Introduction

Financial inclusion is both a cause and consequence of economic growth. Financial inclusion has become a catchphrase in development policy. It is being regarded as an important and inevitable milestone in achieving inclusive growth. The process of economic growth must struggle to cover participation from all sections of society. Lack of access to finance for vulnerable and financially weak sections of the society has been recognized as a serious threat to overall economic

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progress, especially in the developing countries. In fact, prolonged and persistent deprivation of banking services to a large segment of the population leads to fuel social tensions causing social exclusion; and so, in this context, poverty management has become the most crucial issue.

It is often commonly agreed that one of the most important instruments of poverty management would be the viable expansion of institutional credit facilities to a large majority of individuals who neither have adequate collateral nor a dependable credit history to secure a loan repayment. Access to finance, especially by the poor and vulnerable groups is a prerequisite for employment, economic growth, poverty reduction and social cohesion.

The poor individual, by definition, lack any asset that can serve as collateral with the lending institutions. However, the poor rural people live in a strong community framework governed by social pressure where the denial of social support would endanger their sheer existence. Under this strong social bondage the use of peer pressure (Stiglitz, 1990) may play a positive role in fostering repayment incentives in group -lending programs. This pressure itself acts as collateral and unlike financial collateral this one is not an appropriable asset in the event of defaulter; it is just a device for making default more costly to the borrowers (Besley & Coate, 1995). If instead of any particular individual, the loan is granted to a group and the group, as a whole is held responsible for the repayment of the loan then that creates incentives for individual group members to screen and monitor the other group members and to enforce repayment.

For the last three decades development experiences of different countries are strongly vouching the potentials of micro credit and group lending. The root cause of failure of the social banking program is located in the asymmetric information between the lender and the borrower making the individual lending policy extremely costly and absolutely ineffective In fact, the causes are related to the problems of hidden information and hidden action in the form of adverse selection, moral hazard, and enforcement problems. To overcome these problems group lending is considered as a definitely safer option. Since the group has much better access to local information it is possible for the group to make a distinction between risky and safe borrower. The lender has to design some incentive (threat) scheme for the group to utilize the information in the interest of the lender. Thus, group will in effect act as an agent of the lender. If the group is held responsible for non-performance of any one of the group-member, then it would simply raise the cost of default and because of peer monitoring the repayment rate would improve.

A series of research studies (NABARD, 2013) revealed that despite having a wide network of rural bank branches that implemented specific poverty alleviation programs and self-employment opportunities, through bank credit for almost two decades, a very large number of the poor continued to remain outside the fold of the formal banking system. These studies also showed that the existing banking policies, systems and procedures, and deposit and loan products were

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perhaps not well suited to meet the most immediate needs of the poor. It also appeared that what the poor really needed was a better access to these services and products, rather than cheap subsidized credit. Against this background, a need was felt for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms, which would fulfill the requirements of the poorest, especially of the women members of such households.

It is observed that a large section of the Indian population continued to remain excluded even from the most basic opportunities and services provided by the formal financial sector. Most of them are economically active. They need to be provided with financial services, and thus to be accommodated under the umbrella of Financial Inclusion Initiative (FII) of the Government of India (GOI). In order to address the issues of FII, the GOI constituted a "Committee on Financial Inclusion" under the Chairmanship of Dr. C. Rangarajan. The Committee submitted its final **report** on January, 2008; and has defined Financial Inclusion as: *"... the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost".* (NABARD, 2013)

2 Literature Review

It is often commonly agreed that one of the most important instruments of financial inclusion would be the viable expansion of institutional credit facilities to a large majority of individuals who neither have adequate collateral nor a dependable credit history to secure a loan repayment. To address this problem, the government in many developing countries pursued the program of subsidized credit till the 1980s. But, the credit-subsidy programs failed to promote banking culture among the target group and proved inadequate to motivate them to be self-dependent. In addressing the problems of rural credit, two aspects deserve close attention: easy access to loans for the poor (both for production and consumption purposes), and financial viability of the lending institutions. To achieve both these ends simultaneously the idea of social capital is popularized through the group lending programs. JLGL attempts to address the root causes of non-viability of the institutional credit support system for the poor. It, by use of peer monitoring, peer pressure and social sanction, tries to resolve the information asymmetry problems arising out of hidden information and hidden action. The microcredit movement has shown that despite high transactions costs and no collateral, it is possible to provide poor people in rural areas, with credit facilities for setting up or expanding business, for investing in self-employment generating activities and thereby increasing household security.

The literature on JLGL attempts to address the root causes of non-viability of the institutional credit support system for the poor, and then tries to resolve the problems. A formal credit institution has a difficult time distinguishing between inherently risky and safe borrowers in its pool of loan applicants. One advantage of the group lending principle is that it can put local information to work for the outside lender. *Adverse selection* is mitigated under group lending. In an economy where all villagers (safe and risky) know each others' types, the group lending with joint liability will induce assortative matching: the safe borrowers will form groups among themselves, and risky borrowers will have no choice but to form groups with other risky borrowers (Ghatak, 1999; Ghatak & Guinnane, 1999; Tassel, 1999; Morduch & Aghion, 2004).

Group lending with joint liability can potentially mitigate *ex-ante moral hazard* problems as well. This problem emerges under individual liability scheme when, after having extended loans, the financial institution cannot effectively monitor borrowers and the borrowers may be tempted to undertake riskier projects than the bank would like. The gain to the borrowers is that even though such projects may yield a lower return on average, if successful, their returns from such projects can be very high. Since the borrower does not face the full consequences of failure (due to limited liability), tensions emerge. Joint liability clause performs this peer monitoring job and enforces the borrowers not to undertake risky projects (Aghion, 1999, Conning, 1999).

A third potential benefit of group lending is by reducing *ex-post moral hazard*. This problem emerges once project returns have been realized. When the financial institution cannot observe such returns the borrowers, who are protected by limited liability, have incentives to pretend that their returns are low, i.e., to strategically default on their debt obligations. Group lending with joint responsibility can, however, lower the incidence of such strategic default (Aghion & Morduch, 2004).

JLGL mechanism has been developed on the assumption of the existence of *social capital,* and *social sanction*. Most of the theoretical literature is almost silent about the generally accepted definition of social capital. In this paper, as any form of capital (i.e. physical and human capital), social capital refers to a specific asset that yields a stream of benefits over time. An individual's reputation for being cooperative within a social network is such an asset. The mere fact of having a "good name" and to be known by others as trustworthy may generate job opportunities, lower transaction costs, attract clients, etc. (Annen, 2003). Social capital can be seen as a notion that is based on the premise that social relations have potential to facilitate the accrual of economic or non-economic benefits to the individuals. Thus, social capital implies the present value of various forms of social interactions, such as socializing, favor exchange, and/or other arrangements supported by the peer members' relationship etc. and termination of such a relationship for an individual is often known as the social sanction cost.

It is to mention here that while Joint Liability Group Lending (JLGL) has become hugely popular as an instrument for overcoming difficulties of rural credit markets, there are other

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mechanisms that micro lenders use in practice, often in conjunction with the joint liability mechanism. Often credit to the group is preceded by compulsory saving deposits by the group members over a period of time. Group savings is then used as collateral against any defaulting member of the group. This "*savings-up*" (Sinha, 2005) mechanism obviously enhances the borrowers' incentives for peer monitoring since every borrower's own savings is at stake if one of her partners defaults. Sometimes incentives may be created through the provision of *contingent renewal* (Ghosh and Roy, 1997). Lender's *direct monitoring* (Roychowdhury, 2005) also may lay important regulatory role. Generally the lending risk would be abated through *sequential lending* (Roychowdhury, 2005) and repayment may be encouraged through *progressive lending* (Roychowdhury, 2005). Sometimes the lenders may motivate the borrowers by promising some *joint benefit* (Bhattacharya et al, 2008) and this may come as an alternative to the joint liability clause. Since providing a common benefit to all members of a certain group is often subject to a scale effect, even in absence of peer monitoring, this mechanism can increase the repayment probability. Moreover, the incentives for peer monitoring still remain intact and therefore with possibility of social sanction the repayment probability increases further.

3 JLGL and Financial Inclusion Initiative in India

Inclusive economic growth has been one of the priority agendas of the Government of India (GOI) over the past decade. It is widely acknowledged that inclusive economic growth cannot be accomplished without achieving financial inclusion for the nearly two-thirds of India's population who are unbanked. **NABARD aims at to** facilitate sustained access to financial services for the unreached poor in rural areas (through various microfinance innovations) in a cost effective and sustainable manner, and **to** link nearly 9.2 crore households by the end of year 2015. NABARD takes pride in the fact that the Self Help Group - Bank Linkage Programme, which is the largest microfinance programme in the world, today touches nearly 11 crore households through more than 87 lakh SHGs with deposits of over Rs. 19500 crore and annual loan off take of more than Rs. 47000 crore and loan outstanding of over Rs. 75500 crore (NABARD, 2017-18).

For the *Financial Inclusion Initiative* (FII) in India, the "Committee on Financial Inclusion" under the Chairmanship of Dr. C. Rangarajan has recommended setting up of two funds - Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF). The two funds have been established with National Bank for Agricultural and Rural Development (NABARD), with its Financial Inclusion Department (FID) as the nodal department of the GOI.

Several initiatives are taken by the Government of India, the Reserve Bank of India, NABARD and Banks to bring the poor into the fold of formal financial service providers, and serious attempts have been made to leverage the Joint Liability Group Lending (JLGL) or Self Help

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Group-Bank Linkage Program (SHG-BLP) to achieve the Financial Inclusion (FI) goals. Actually, there is a need for JLGL and/ or SHG-BLP, and FII working in a complimentary manner, synergizing the strengths, and ensuring effective banking footprints in remotest of hinterlands.

To promote FII in India, NABARD has been constantly supporting formation of informal groups like Joint Liability Groups (JLGs) with 4-10 members. Both theoretically and in practice, it is generally found that financing of Joint Liability Groups (JLGs) is a good business proposition from the lenders perspective also. JLGL projects need simplified documentation, group dynamics, timely repayment culture and prospects of credit enhancement to quality clients.

JLGs are intended basically as credit groups for tenant farmers and small farmers who do not have proper title of their farmland or security to offer, but needed longer term credit or seasonal credit for pursuing their economic activities. NABARD supports banks for nurturing and financing of JLGs and has issued comprehensive guidelines on JLGs to Banks. Thus, regular savings by JLG is completely voluntary in nature. NABARD not only extends financial support for awareness creation or capacity building of all stakeholders, but also extends complete refinance support to Banks on their lending to JLGs. Almost 1,96,500 JLGs were promoted and credit linked during 2012-13, as against 1,91,500 JLGs promoted during the previous year. There has been expansion in credit flow to JLGs to the extent of Rs. 1,837.64 crore as against Rs. 1,700.33 crore, i.e., 8% increase over the previous year, taking the cumulative number of JLGs to 5,29,246 (which was 3.32 lakh in 2011-12) and the cumulative loan disbursed to JLGs to Rs. 4,683.33 crore (that was 2845.68 crore in 2011-12) (NABARD, various issues).

For the last three decades, it has been witnessed that a substantial amount of resources being earmarked towards meeting the credit needs of the poor. The branch expansion of the nationalized banks is synergized with massive manpower recruitment drive for manning such branches. The launching of NABARD’s Pilot phase of the SHG-BLPs in February, 1992 could be considered as a landmark development in banking with the poor.

The strategy involved is forming small, cohesive and participative groups of the poor, encouraging them to pool their thrift regularly and using the pooled thrift to make small interest bearing loans to members, and in the process learning the nuances of financial discipline. Subsequently, bank credit also becomes available to the Group, to augment its resources for lending to its members. It needs to be emphasized that NABARD sees the promotion and bank linking of SHGs not as a credit program, but as a part of an overall arrangement for providing financial services to the poor in a sustainable manner and also an empowerment process for the members of these SHGs.

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The microfinance sector in India is considered to be one of the main contributors to financial inclusion in the country. The journey, initiated by NABARD, so far navigated by the SHG-BLP has crossed many milestones – from linking a pilot of 500 SHGs of rural poor two decades ago to cross 8 million groups a year ago. Similarly from a total savings corpus of a few thousands of Indian Rupees in the early years to a whopping Rs. 27,000 crore today, from a few crore of bank credit to a credit outstanding of Rs. 40,000 crore and disbursements touching Rs. 20,000 crore during 2012-13 (NABARD, 2013). The geographical spread of the movement has also been quite impressive - now spreading to even the most remote corners of India. Over 95 million poor rural households are now part of this world's largest microcredit initiative. The poor in the country have demonstrated that inspite of being poor; they are, perhaps, the most "bankable" clients and most willing to help each other for a better tomorrow (NABARD, 2013).

it is clearly seen that there is an increasing trend in the total number of SHGs, in the SHG savings with banks over the years, except the last year. In fact, there is a decline in the total number of SHGs savings linked with banks, to the extent of 8.1% during the year 2012-13, though the savings harnessed by SHGs grew by 25.4% during this year. But it is to note that during the last five years, total 358.14 lakh numbers of SHGs are newly formed. They are linked with banks with their savings; and the total savings harnessed by these SHGs during the same period is Rs. 33,529.29 crore. That means, during the last five years, the average savings generated by these SHGs are around Rs. 9,362/- (NABARD, various issues).

Table 2 further shows that the number of all women SHGs has increased over the last five year, except the last year. There is a decline in the number of all women SHGs whose savings linked with banks, to the extent of 5.7% during the year 2012-13, though the savings harnessed by the all women SHGs grew by 27.6% during this year. But, it is interesting to note that among those total 358.14 lakh numbers of SHGs with savings linked with banks, 285.09 lakh of SHGs are operated solely by the women, and these all women SHGs have generated a savings of Rs. 25850.53 crore during the last five years. So, during the last five years, the average savings by these SHGs are around Rs. 9,067/- (NABARD, various issues).

It is seen that after nearly 3 years, the number of SHGs availing fresh loans by banks showed an increase of 6.3% during the year 2012-13, and the quantum of fresh loans issued increased by 24.5% to Rs. 20,585.36 crore over the previous year. During the last five years, total 67.61 lakh numbers of SHGs have been disbursed loans of total amount of Rs. 78374.61 crore (NABARD, various issues). That means, average loan size per SHG is around Rs. 1,15,922/-. Moreover, it is interesting to note that during the last five years, total 56.46 lakh numbers of all women SHGs have been disbursed loans of amount Rs. 67565.41 crore with an average loan size of Rs. 1,19,670/-. That means, the loan size, in all the cases, is almost six times the average savings size

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(Rs. 9,362/-) generated by the SHGs in the banks. In theoretical literature, this is popularly known as "Savings-up mechanism" (Sinha, 2005).

During 2017-18, a record number of SHGs, 25.86% of total SHGs, were provided with institutional credit, highest so far in a single year. Banks disbursed Rs. 47,186 crore loans to 22.61 lakh SHGs during the year, as compared to 18.98 lakh SHGs during 2016-17. The number of SHGs availing bank loan during the year was more than the previous year in case of all Regions except Central Region, which recorded a decline mainly due to a fall in the number of credit linkage of SHGs in Chhattisgarh and Madhya Pradesh. Against one in every four SHGs on an average at all India level, one in every three SHGs in Southern Region and Eastern Region have availed bank loan during the year whereas in other regions, the credit coverage of SHGs was much less (ranged between 7.21% and 11.75%) as compared to the national level (NABARD, 2017-18).

Credit linkage of SHGs during the year was high in Southern states like Telangana, Karnataka, Andhra Pradesh and Kerala. Some other states like Jammu & Kashmir, West Bengal and Bihar also have high credit linkage during the year. Low credit linkage in North Eastern states and some priority states like Uttar Pradesh, Gujarat, Rajasthan, Madhya Pradesh, Chhattisgarh, etc. remains a concern. In states like Chhattisgarh, Madhya Pradesh, Gujarat, Andhra Pradesh, Tamil Nadu, etc., the number of SHGs provided with bank loan during 2017-18 was lesser than the previous year. On the other hand, as compared to previous year, more number of SHGs were provided bank loan during 2017-18 in states like Jammu & Kashmir, Jharkhand, Odisha, Bihar, West Bengal, Karnataka, Kerala, Maharashtra, etc (NABARD, 2017-18).

4 Conclusion

Financial inclusion means much more than simply having or not having a bank account: it means not only the mere availability of services, but also to their adoption and usage. The microcredit movement has shown that despite high transactions costs and no collateral, it is possible to provide poor people in rural areas, with credit facilities for setting up or expanding business, for investing in self-employment generating activities and thereby increasing household security. The group-lending programs have proven able to reach poor individuals, particularly women that have been difficult to reach through alternative approaches.

Improved access to microcredit services enables the poor to smooth out their consumption, manage their risks better, build their assets, develop their micro-enterprises, enhance their income earning capacity, and enjoy an improved quality of life. Microcredit services have a significant positive impact on the depth (severity) of poverty and on specific socio-economic variables such as children's schooling, household nutrition status, and women's empowerment.

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In India, a successful program like JLGL, SHG-BLPs, being leaded by NABARD, could link millions of rural poor to formal banking system and that could have been the main instrument for Financial Literacy (FL) and Financial Inclusion (FI) in the country. There is number of plausible ways by which matured JLGs and SHGs could have been participants in the FI initiative, including being agents of providing direct banking services to the poor at their doorsteps, as a low cost and efficient alternative. This model is certainly more cost effective and reliable alternative to the existing inclusion agenda and millions of households, now members of JLGs, SHG-BLPs, would have been the immediate beneficiaries (NABARD, 2012).

India has one of the largest and most active financial inclusion markets in the world. The Indian

Government has recognized its role in financial inclusion by joining CGAP as a member during 2012. India is also participating in the G20's Global Partnership on Financial Inclusion. India also brings into the global dialogue a diverse set of approaches to financial inclusion: SHGs, MFIs, Commercial Banks, Insurance Companies, Pension Funds, Cooperatives and agent-banking through Business Correspondents. Though one in three adult Indians has a bank account, a figure higher than many low-income countries, but it also indicates how much more work remains to be done.

There is a need to critically examine the causes and issues in underserved areas of Self Help Group Bank Linkage Programme at a granular level and devise strategies for intervention. This calls for redefining the priority states and strategy for such states with particular emphasis on Central, Eastern India and North-Eastern regions. Mapping of potential could be one of the interventions.

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