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Rural Financial System Development

SHG Banking in India: The evolution of a rural financial innovation by

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List of Abbreviations

APRACA	Asia-Pacific Rural and Agricultural Credit Association
ADB	Asian Development Bank
AMPS	Advanced Multi-Stakeholder Planning System
AP	Andhra Pradesh
BAAC	Bank for Agriculture and Agricultural Cooperatives, Thailand
BI	Bank Indonesia
BIRD	Bankers Institute of Rural Development
BKD	Badan Kredit Desa, Indonesia
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (Federal Ministry for Economic Cooperation and Development)
BPR	Bank Perkreditan Rakyat, Indonesia
BRI	Bank Rakyat Indonesia
CARE	Cooperative for American Remittances to Europe
CIDA	Canadian International Development Agency (CIDA)
CRS	Catholic Relief Services
DEAR	Department of Economic Analysis and Research
DFID	Department for International Development, UK
DGRV	Deutscher Genossenschafts- und Raiffeisen Verband / German Cooperative and Raiffeisen Confederation
DPD-NFS	Development Policy Department Non-Farm Sector
EU	European Union
FA	Financial Assistance
FAO	Food and Agriculture Organization of the United Nations
GDP	Gross Domestic Product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH (German Technical Cooperation)
IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
KfW	Kreditanstalt für Wiederaufbau
MACS	Mutually Aided Cooperative Societies
MCIC	MicroCredit Innovations Cell
MCID	MicroCredit Innovations Department
MDG	Millennium Development Goal
MFI	Microfinance Institution
MIS	Management Information System
MYRADA	Mysore Resettlement and Development Agency
NABARD	National Bank for Agriculture and Rural Development
NGO	Non-Governmental Organisation
NPA	Non-performing assets
NRO	Nichtregierungsorganisation
ODA	Official Development Assistance
PACS	Primary Agricultural Cooperative Societies
PRADAN	Professional Assistance for Development Action
RBI	Reserve Bank of India
RRB	Regional Rural Bank
Rs	Rupee (Indian Currency Unit)
SDC	Swiss Agency for Development and Cooperation
SEWA	Self-Employed Women Association
SHG	Self-help group / Selbsthilfegruppe
SHPI	Self-Help Promotion Institution
TC	Technical Co-operation
UK	United Kingdom
UN	United Nations
UNDP	United Nations Development Program
US	United States of America
USAID	United States Agency for International Development
ZOPP	Ziel-orientierte Projekt Planung / objective oriented project planning (GOPP)

Executive summary

1. Introduction

the developing world's largest and fastest-growing microfinance program

Linking banks and self-help groups in India is the largest and fastest-growing microfinance program in the developing world. Implemented since 1996 on a national scale, it has reached 1.6 million savings-based groups credit-linked to 35,294 bank branches, with 23.96 million members covering over 120 million people from the lowest strata of the rural population (End of March 2005). Performance is excellent, and impact is deeply felt by the members, the vast majority of them women. Yet enormous challenges remain, particularly in terms of further expansion into underserved areas and sustainability.

Linking banks and self-help groups has been a major program of German development cooperation since the mid-1980s. Given the involvement of GTZ in SHG banking and the outreach of that program in India, the German Ministry of Economic Cooperation and Development (BMZ) has proposed to study the impact of SHG banking in India in the framework of the United Nations Millennium Development Goals 2015 on the basis of the existing literature; and subsequently to examine the contribution of GTZ on the evolution of the program in India. The results of the impact studies indicate that considerable socio-economic benefits have been accruing to small-scale farming households, rural micro entrepreneurs and the landless and have contributed to most impact aspects of MDGs 1 to 6. Most SHG members substantially increase their saving rates. A shift has been observed over time from consumption loans to loans for income generating purposes. Increased savings and capital formation improve the self-financing capacities and even out the household's cash flow. This in turn has improved their risk absorption capacity and made them less vulnerable. Access to formal finance has substantially reduced dependency on money lenders and has diminished capital costs. The improved access to financial services has benefited SHG members and their households in maintaining, intensifying and diversifying their economic activities, with positive effects on income and employment generation, especially in the non-agricultural sector. Based on the synopsis it is recommended to support: institution building including in existing SHGs and SHG federations; the consolidation of financial services through more effective management information systems; capacity building of SHG members; expansion of outreach particularly in the central and eastern regions; feasibility studies of different delivery models; and the integration of SHG banking into other development programmes. These recommendations have been confirmed in the discussions during March 2005.

The unprecedented scale of SHG banking and its enormous potential for further growth, within India and without, raises the question as to the dynamics of its evolution, the forces behind it, and the contribution of external organizations. How did it evolve, what kept it growing, and what has been the role of GTZ? The study is mainly based on discussions in March 2005 with key personnel and on the analysis of documents of APRACA, GTZ and NABARD.

2. A paradigm shift in rural finance in India and Germany

In India, the lack of rural development has been attributed since the 1950s to a lack of production assets and credit. The nationalization of private banks in 1969, the expansion of their rural branch network, priority sector lending and the introduction of Regional Rural Banks in 1975, plus large amounts of donor funding, substantially increased outreach to better-off farmers. Yet, all this failed to reach the vast numbers of landless people, agricultural laborers and illiterate women, as substantiated by a survey of RBI in 1981. When the German Government and other major donors reviewed their credit lines to development banks, they arrived at similar conclusions as RBI: that cheap credit had in fact undermined rural development. Germany's experience during that period differed widely from that of India. The massive capital transfer through the Marshall Plan, channelled through KfW, led to Germany's economic miracle. Well into the 1960s private commercial banks were absent

from rural areas; but unlike in India, two informal self-help initiatives, dating back to the second half of the 18th and the middle of the 19th century, respectively, had evolved into a wide network of self-reliant savings and cooperative banks with near-total outreach: a crucial element in Germany's comparative advantage in development experience. 1983 was a turning year in both countries in their search for a new paradigm in development finance: bringing together governmental and private agencies, adopting a savings-led approach, and searching for grassroots organizations as financial intermediaries such as SHGs.

3. Linking banks and self-help groups: a rural finance innovation

In this climate of a paradigm change in rural finance, NABARD experimented with NGOs by establishing credit management groups. GTZ developed the concept of linking banks and SHGs and supported feasibility studies in the African context, where financial SHG groups were found in abundance, but no banking partners.

4. The emergence of SHG banking in India

The decisive event which brought the linkage approach to the attention of policymakers and banks in Asia including India was the APRACA regional workshop in Nanjing, China, in May 1986. The linkage approach was subsequently adopted by APRACA as its priority program and supported by a GTZ regional project.

Key elements were:

- building on the existing formal and nonformal financial infrastructure, including SHGs as informal financial intermediaries;
- savings-based credit linkages with banks;
- NGOs (SHPIs) as facilitators;
- flexible models of cooperation between SHGs, NGOs and banks as autonomous business partners, each with its own existing financial and institutional resources.

In preparation of pilot linkage projects, India carried out a survey with its own funds and experts, while GTZ supported studies in a number of other APRACA member countries. These led to the first pilot project, namely in Indonesia in 1988, supported by GTZ and followed by other bilateral projects in the Philippines and Thailand. Its operational guidelines were reviewed and revised by NABARD and discussed at a joint workshop in Jakarta in February 1992.

5. SHG banking in India: from pilot project to mainstreaming

Inspired by the APRACA-GTZ regional project, NABARD carried out its own pilot project, 1992-96. At mid-term, March 1994, 637 SHGs promoted by NGOs had been credit-linked to 28 banks, with a positive impact. On that basis, NABARD initiated mainstreaming of SHG banking, setting up a Credit and Financial Services Fund in 1996 for extensive capacity-building and a Micro Credit Innovations Department (MCID) in 1998, with MCI cells in every state. The number of SHGs credit-linked to banks grew to 33,000 in 1999 and 115,000 in 2000 and during the following years surged to 1.6 million at the time of this study, March 2005, surpassing the goal originally set for 2008.

6. GTZ's role in the SHG-Bank Linkage Program in India

Through the APRACA-GTZ regional project, communication on SHG banking among member institutions and GTZ-supported bilateral projects was maintained; documentation of linkage experience in member countries was widely circulated. The initial success of its pilot project led NABARD to request technical assistance from GTZ for the mainstreaming of SHG banking. On 31 August to 2 September 1994, a ZOPP workshop was held in Bombay for the planning of a bilateral project. The main emphasis of the bilateral project was to be on capacity building, particularly through exposure training abroad, supported through a financial contribution as the main component and short-term experts. Workshop participants agreed that the management of the SHG-Bank Linkage program rested with NABARD. The bulk of all resources was to be provided by NABARD and the banks. GTZ support was to be

ancillary, both in financial and management terms. GTZ subsequently submitted to NABARD a proposal for a bilateral project with a long-term expert. This was not immediately accepted by the board, which had general objections against small experimental project and voiced doubts over the prospects of uncollateralized lending to informal groups. It was only after prolonged negotiations and living proof that SHG banking was no longer a small project of doubtful value that a bilateral project was signed in 1998 and took off in 2000, with its base in Delhi.

The main contribution of GTZ to SHG banking in India is seen by NABARD's management in the preparatory phase, mainly during the period 1986 and 1994, followed by specific inputs during the maturity phase of the program since 2000. Historically, there are four seminal inputs through which GTZ contributed to a self-sustaining evolutionary process of SHG banking in India, fully owned and managed by NABARD and its partner agencies in India:

- Conceptual development of the linkage model by GTZ and its presentation at the APRACA workshop in Nanjing, with a trigger effect on NABARD's own search for a new approach in rural finance
- Providing a framework for a study of SHGs in India, carried out by a consortium of Indian institutions under the leadership of NABARD, preparatory of a pilot project
- Preparation and initial test of operational procedures of linkage banking through a bilateral project in Indonesia: a blueprint for the first phase of the pilot project in India
- Continual support for the APRACA-GTZ regional project Linking Banks and Self-Help Groups, providing a regional communication forum for the exchange of experience.

Of particular value during the last four years has been GTZ's support to intellectual dialogue, exposure abroad, and special studies. Initiatives commended by NABARD include:

- Exposure visits to Germany and related studies have helped preparing the ground for cooperative sector reform and a bilateral project component.
- Exposure visits to Uganda as well as Indonesia have opened new perspectives on how to supervise small institutions and institutions with small accounts.
- Exposure visits to Indonesia have broadened views on microfinance.
- An exposure visit to Bolivia has demonstrated the usefulness of smart cards as a device to reduce transaction costs and is now being pilot tested by NABARD.
- A study of demand-led savings products, including life, health and accident insurance, is cited as particularly important. Once 10-15 million SHG members are covered by group health insurance, premiums will go down substantially.
- The studies presented at the tenth anniversary of SHG-Bank Linkage program in India in October 2002, with support from GTZ, IFAD and SDC, have enabled NABARD to subject the strengths and weaknesses of the program to external scrutiny and have provided a basis for the international dissemination of the approach.
- Studies of bank and SHG transaction costs have provided indicative evidence of the profitability of SHG banking. This has contributed to a surge in SHG linkages.
- Various contributions have been made to NABARD's MIS of SHG banking; its improvement at different levels is an ongoing concern.
- Staff members of NABARD joined several international training events, eg, in Thailand and Sri Lanka and the microbanking training of Bankakademie in Frankfurt.
- GTZ has supported the South-South dialogue between NABARD and other GTZ projects and programs included high-level delegations.

The vigor and diversity of the *SHG-Bank Linkage program* in India may precisely be due to the fact that NABARD, in cooperation with its Indian partners, took full command of the program and kept any donor assistance at an institutional distance. In the words of NABARD leaders, "*GTZ has made a significant contribution, but (this is) difficult to attribute exactly.*" What has been most important to NABARD is the flexibility of support where it would have had difficulty getting approval for the use of its own funds. Of particular value during the last four years has

been GTZ's support to intellectual dialogue, exposure abroad, and special studies. One of the most fruitful contributions in the eyes of NABARD is a spin-off of the ongoing bilateral project, a study of the German cooperative rural banking system, which has resulted in a second program component in addition to SHG banking.

7. Expected future collaboration

There are several fields where NABARD realizes that GTZ has a strong comparative advantage, based on its own historical experience, which complements the historical experience and competitive advantage of NABARD. The following types of support have been suggested:

- policy-oriented exposure visits of large numbers of policy- and decision-makers to Germany and other countries with relevant experience in rural finance
- high-level policy seminars in India on selected topics in rural finance
- capacity building at NABARD and facilitating institutions
- further improvements in the MIS
- supporting the development of SHG federations as financial intermediaries or promoters of microenterprises and marketing through studies and capacity-building
- reforming cooperative finance through exposure visits, high-level policy seminars and perhaps bilateral projects with key banking institutions
- exposure training and workshops on an appropriate supervisory framework
- testing alternative delivery models, such as joint liability groups (as in BAAC/Thailand)
- supporting research and workshops on financial products to cope with land fragmentation
- systematic research on SHG banking
- international dissemination of the Indian SHG banking experience
- spreading the message in the microfinance community that rural banks in India provide microfinance services and in this sense are MFIs; presenting SHG banking at the same time as a major contribution to *inclusive finance*.

8. Development cooperation with an *Ankerland* (anchor country)

Development cooperation with an *Ankerland* (anchor country) like India, where planning capacities and financial resources are well developed, is a new challenge. A number of tentative suggestions have emerged from our discussions:

- Focus on areas where Germany has a comparative advantage of experience within Germany or in the developing world, and provide short-term experts in such fields
- Facilitate the exchange of experience with Germany and relevant other countries through systematically organized exposure visits of decision-makers
- Support high-level policy dialogues in India
- Support systematic research on selected topics
- Direct TC directly at local institutions and their networks
- Promote the international dissemination of innovations from India (eg, SHG banking)
- Include Indian experts in GTZ teams designing projects in other countries
- Discuss the feasibility of bilateral pilot projects in key institutions such as selected cooperative or regional rural banks or banking associations
- Promote donor coordination and collaboration, particularly with FA donors without a field presence to increase overall effectiveness and depth of outreach.

**SHG-Banking in Indien:
Die Evolution einer Innovation im ländlichen Finanzwesen und der Beitrag der GTZ**

Zusammenfassung

1. SHG-Banking, das weltgrößte ländliche Mikrofinanzprogramm

SHG-Banking, die Anbindung von Spar- und Kreditselbsthilfegruppen an Banken in Indien, ist das größte und wachstumsstärkste ländliche Mikrofinanzprogramm in Entwicklungsländern. Seit Beginn seiner landesweiten Umsetzung 1996 wurden 1,6 Millionen Gruppen mit 23,96 Millionen Mitgliedern von ca. 36,000 Bankzweigstellen refinanziert; das entspricht einer Gesamtbevölkerung von über 120 Millionen. Aus Sicht der Banken wie auch der Mitglieder, die weitaus meisten davon Frauen aus den untersten Schichten, hat sich das Programm als äußerst erfolgreich erwiesen. Dabei sieht sich die staatliche Agrarzentralbank NABARD, Programmträger und zugleich Durchführungsorganisation, weiterhin gewaltigen Herausforderungen der Konsolidierung und Nachhaltigkeit gegenüber.

Die Anbindung von SHG an Banken wird von der Bundesrepublik seit Mitte der 1980er Jahre gefördert. Wegen des außerordentlichen Ausmaßes der Zielgruppenerreichung in Indien hat das BMZ eine Wirkungsstudie auf der Grundlage der vorhandenen Literatur als Beitrag zu den UN Millennium Development Goals 2015 sowie eine Untersuchung über den Beitrag der GTZ in Auftrag gegeben. Gemäss der Ergebnisse der drei Wirkungsstudien entsteht durch das weiterhin schnell wachsende Programm ein erheblicher sozio-ökonomischer Nutzen für kleinbäuerliche und -gewerbliche Unternehmer/innen und Landlose. Der verbesserte Zugang von SHG-Mitgliedern zu Mikrofinanzdienstleistungen sowie der Gruppenansatz und die damit zusammenhängenden Prozesse zur Stärkung des Humankapitals tragen mit vielfältigem Nutzen zu den meisten Wirkungsaspekten der MDGs 1 bis 6 bei. Die meisten SHG-Mitglieder steigern in beträchtlichem Umfang ihre Sparraten. In der Kreditaufnahme werden verstärkt Darlehen für einkommensschaffende Aktivitäten statt für Konsumzwecke nachgefragt. Erhöhte Spareinlagenmobilisierung und Kapitalbildung verbessern die Kapazitäten zur Eigenfinanzierung kleinerer Investitionen. Weiterhin wird der Cash-flow der Haushalte stabilisiert und es kann generell von höheren Kapazitäten zur Absorption von Risiken ausgegangen werden. Der Zugang zu formalen Finanzdienstleistungen trägt auch zu einer starken Verringerung der Abhängigkeiten von informellen Geldverleihern bei, mit positiven Wirkungen auf die Reduzierung der Kapitalkosten. Die Finanzdienstleistungen mit ihren Einkommenswirkungen erhöhen auch die Kapazitäten der SHG-Mitglieder, zusätzliche Ausgaben für Grundbedürfnisse wie verbesserte Ernährung (MDG1), Bildung (MDG 2) und Gesundheit (MDGs 4 bis 6) zu tätigen. Als Ergebnis der Synopse wird empfohlen, die institutionelle Entwicklung existierender SHG und SHG-Verbandsstrukturen zu fördern; weiterhin zur Verbesserung effektiver Managementinformationssysteme (MIS) und damit zur Konsolidierung des Programms beizutragen; zur Kapazitätsverbesserung der SHG-Mitglieder beizutragen; zum Abbau regionaler Unausgewogenheiten die Zentral- und Ostregionen verstärkt zu berücksichtigen und dabei ggf. regionalspezifisch unterschiedliche Durchführungsmodelle zu entwickeln; die Entwicklungsrolle der SHG durch eine verbesserte Einbeziehung in örtliche Entwicklungsprogramme auszubauen.

Umfang und Wachstumspotential des Programms inner- und außerhalb Indiens werfen die Frage nach seiner Entstehungsgeschichte und Entwicklungsdynamik auf, insbesondere auch nach dem Beitrag der GTZ. Diese Studie beruht weitgehend auf Gesprächen mit Entscheidungsträgern des Programms im März 2005 und auf der Analyse von Unterlagen beteiligter Organisationen, insbesondere APRACA, GTZ und NABARD. Die Empfehlungen der Wirkungsstudie konnten durch die Gespräche im März 2005 bestätigt werden.

2. Paradigmenwechsel im ländlichen Finanzwesen in Indien und Deutschland

Seit den 1950er Jahren wurde die ländliche Unterentwicklung in Indien weitgehend auf einen Mangel an Produktionsmitteln und Krediten zurückgeführt. Die Nationalisierung privater Banken 1969 und die Ausweitung ihres ländlichen Zweigstellennetzes, die Einführung eines

neuen Netzwerks ländlicher Regionalbanken (RRB) seit 1975 und die Durchleitung beträchtlicher Geberkredite führten für die größeren Bauern zu einer erheblichen Verbesserung der Kreditversorgung, nach einer Untersuchung der Reserve Bank of India (1981) nicht aber für die 250-300 Millionen Menschen der untersten Schichten. Etwa gleichzeitig evaluierten die größeren Geber, darunter Deutschland, ihre Entwicklungsbankenkredite, mit dem gleichen Ergebnis wie RBI: der subventionierte Agrarkredit untergräbt die ländliche Entwicklung. Deutschlands eigene Erfahrung in der Nachkriegszeit unterschied sich grundlegend von der Indiens: Einerseits trug der massive Kapitaltransfer aus Marshallplanmitteln über die KfW zum Wirtschaftswunder bei. Andererseits waren zwar in Deutschland bis in die 60er keine privaten Geschäftsbanken in ländlichen Gebieten tätig; im Gegensatz zu Indien hatten sich aus den informellen Selbsthilfeansätzen des 18. und 19. Jahrhundert aber umfangreiche Netzwerke selbsttragender Sparkassen und Genossenschaftsbanken entwickelt: ein wesentlicher komparativer Erfahrungsvorteil in der Entwicklungszusammenarbeit. 1983 war für beide Länder das Jahr des Durchbruchs zu einem neuen Paradigma der Entwicklungsfinanzierung. Diese war gekennzeichnet durch Zusammenarbeit zwischen privaten und staatliche Organisationen, Ersparnisorientierung und Beginn der Ausrichtung auf SHG als lokale Finanzintermediäre.

3. SHG-Banking: eine Innovation im ländlichen Finanzwesen

In diesem Klima des Paradigmenwechsels experimentierte NABARD in Zusammenarbeit mit NRO mit sog. Kreditmanagementgruppen. Die GTZ entwickelte das Modell der Verknüpfung von SHG und Banken. Durchführbarkeitsstudien im afrikanischen Raum förderten eine Fülle von SHG als informelle Finanzinstitutionen zu Tage, aber keine Bankpartner.

4. Anfänge des SHG-Banking in Indien

Bei der Regionalkonferenz des asiatischen Agrarbankenverbands APRACA in Nanjing (China) im Jahr Mai 1986 stellte die GTZ den SHG-Bankingansatz vor: ein Schlüsselereignis für die Entscheidungsträger aus verschiedenen asiatischen Ländern, darunter Indien. Mit Unterstützung eines Sektorvorhabens der GTZ erklärte APRACA SHG-Banking zu seinem vorrangigen Förderprogramm, mit den folgenden Elementen:

- Aufbau auf vorhandenen formellen und nichtformellen Finanzinfrastrukturen einschließlich SHG;
- Anbindung von SHGs an Banken im Spar- und Kreditgeschäft;
- Einbeziehung von NRO als Fördereinrichtungen;
- flexible Modelle der Zusammenarbeit zwischen SHG, NRO und Banken als autonomen Geschäftspartnern unter Nutzung ihrer jeweiligen finanziellen und institutionellen Mittel.

Zur Vorbereitung von Pilotprojekten führte Indien mit eigenen finanziellen und personellen Mitteln eine Untersuchung über SHG durch, während ähnliche Untersuchungen in anderen asiatischen Ländern von der GTZ durchgeführt wurden. Das erste Pilotprojekt setzte 1988 mit Unterstützung durch die GTZ in Indonesien ein; weitere bilaterale Projekte folgten in den Philippinen und Thailand. Die Durchführungsbestimmungen des Projektes in Indonesien wurden von NABARD überarbeitet und bei einem gemeinsamen Arbeitstreffen in Jakarta im Februar 1992 vorgestellt.

5. SHG-Banking in Indien: vom Pilotprojekt zur nationalen Implementierung

Angeregt durch das APRACA-GTZ Regionalprojekt führte NABARD 1992-96 in Indien sein eigenes Pilotvorhaben durch. Zum Zeitpunkt der Zwischenevaluierung im März 1994 waren an dem Projekt 637 SHGs in Zusammenarbeit mit NRO als Fördereinrichtungen und 28 Banken als Kreditgebern beteiligt. Die Akzeptanz und positive Wirkung des Modells veranlasste NABARD, die nationale Implementierung in die Wege zu leiten. Dazu richtete NABARD 1996 einen eigenen Kredit- und Innovationsfonds und 1998 eine Mikrokreditinnovationsabteilung (MCID) als Steuerungseinheit ein, mit MCI-Zellen in jedem Bundesstaat. Die Zahl der – jeweils auf eigener Ersparnisgrundlage – bankrefinanzierten

SHG wuchs 1999 auf 33,000 und 2000 auf 115,000, danach in gewaltigen Sprüngen bis auf 1,6 Million zum Zeitpunkt dieser Untersuchung im März 2005 – weit über das ursprünglich für 2008 angestrebte Ziel von einer Million Gruppen hinaus.

6. Die Rolle der GTZ im indischen SHG-Bankingprogramm

Durch das APRACA-GTZ Regionalprojekt wurde die Kommunikation mit den Mitgliedern und den bilateralen GTZ-Projekten aufrechterhalten. Die positive Piloterfahrung veranlasste NABARD, bei der GTZ um Unterstützung für die nationale Implementierung des Programms nachzusuchen. Am 31.8.-2.9.1994 wurde in Bombay eine ZOPP-Veranstaltung für die Planung eines bilateralen Projekts durchgeführt, mit dem Schwerpunkt auf Fortbildung, insbesondere durch Exposureaufenthalte im Ausland. Als Hauptkomponente der Förderung war ein Finanzierungsbeitrag vorgesehen, ergänzt durch Kurzzeitexperteneinsätze. Kreditmittel zur Refinanzierung der Banken wurden von NABARD zur Verfügung gestellt. Die Teilnehmer waren sich einig, dass das Management des SHG-Bankingprogramms ausschließlich bei NABARD liegen solle. Eine Entscheidung verzögerte sich, da im Aufsichtsrat von NABARD grundsätzliche Bedenken gegen kleinere TZ-Projekte sowie Zweifel an den Zukunftsaussichten ungesicherter Kredite an informelle Gruppen geäußert wurden. Erst als das Programm seine Akzeptanz bei Banken, NRO und SHG unter Beweis gestellt hatte, wurde nach langen Verhandlungen 1998 ein Übereinkommen über ein bilaterales Projekt erzielt, das 2000 in Kraft trat und in Delhi untergebracht wurde.

Den wesentlichen Beitrag der GTZ zum SHG-Banking in Indien sieht das Management von NABARD in der Vorbereitungs- und Gründungsphase, insbesondere 1986-1994, gefolgt von spezifischen Inputs in der Reifephase des Programms. In NABARDs voller Eigentümerschaft und Führung in Zusammenarbeit mit seinen indischen Partnern entwickelte sich SHG-Banking dabei als ein selbsttragender evolutionärer Prozess in Indien. Dazu hat die GTZ vier wesentliche Beiträge geleistet:

- Entwicklung des SHG-Bankingmodells und seine Präsentation in Nanjing (1986), ein Auslöser (*trigger*) bei NABARDs Suche nach einem breitenwirksamen Ansatz
- Bereitstellung eines Forschungsrahmens für SHG-Studien, in Indien durch ein Konsortium unter NABARDs Leitung durchgeführt
- Ausarbeitung und Test von Durchführungsbestimmungen in einem Pilotprojekt in Indonesien als Grundlage für die Pilotphase in Indien
- Fortlaufende Unterstützung des SHG-Bankingprogramms durch das APRACA-GTZ Regionalprojekt als regionales Kommunikationsforum.

Von besonderer Bedeutung seit 2000 war der Beitrag der GTZ insbesondere zu einem Erfahrungsaustausch im Ausland, hochrangige Dialogprogramme und spezielle Studien. Die folgenden Initiativen wurden von NABARD besonders hervorgehoben:

- Informationsbesuche in Deutschland und nachfolgende Studien haben eine Grundlage für die Reform des Genossenschaftssektors und für eine neue bilaterale Projektkomponente geschaffen.
- Informationsbesuche in Uganda und Indonesien haben eine neue Sicht auf effektive Aufsicht von Finanzinstitutionen mit Kleinkunden vermittelt und das Spektrum von ländlichen Finanzinstitutionen erweitert.
- Ein Informationsbesuch nach Bolivien hat den Beitrag von Smart Cards zur Verringerung von Transaktionskosten demonstriert und zu einem Pilottest in Indien geführt.
- Durch Teilnahme an regionalen Veranstaltungen wurde der Süd-Süddialog zwischen NABARD und anderen von der GTZ unterstützten Maßnahmen gefördert.
- Einer Studie über Sparprodukte in Verbindung mit Lebens-, Kranken- und Unfallversicherung wird besondere Bedeutung beigemessen. NABARD sieht ein Potential für eine Gruppenkrankenversicherung für 10-15 Millionen SHG-Mitglieder, mit drastisch niedrigeren Beiträgen.
- Wesentliche Beiträge wurden zur Verbesserung des MIS geleistet

- Verschiedene, von GTZ, IFAD und SDC geförderte Studien anlässlich des 10. Jahrestags des Programms im Jahre 2002 haben eine internationale Analyse der Stärken und Schwächen des Programms ermöglicht.
- Exemplarische Studien über Bank- und SHG-Transaktionskosten haben die Profitabilität des Programms für die Beteiligten nachgewiesen und wesentlich zur Expansion des Programms beigetragen.
- NABARD-Mitarbeiter haben an internationalen Fortbildungsveranstaltungen teilgenommen, z.B. in Thailand, Sri Lanka und bei der Bankakademie Frankfurt.

Die Dynamik und Vielfalt des Programms in Indien dürfte eng damit zusammenhängen, dass NABARD mit seinen indischen Partnern die volle Durchführungsverantwortung übernommen und Gebereinflüsse auf Distanz gehalten hat. Dazu stellten unsere Gesprächspartner fest: „Die GTZ hat einen wichtigen Beitrag geleistet; aber dieser lässt sich nur schwer genau zurechnen.“ Von größter Bedeutung ist für NABARD die Flexibilität der Unterstützung in Bereichen, für deren Finanzierung aus Eigenmitteln der Vorstand nur schwerlich seine Zustimmung hätte geben können. Als besonders wertvoll wurde immer wieder die Unterstützung des fachlichen Austauschs, der Fortbildung durch Exposureaufenthalte im Ausland und besonderer Untersuchungen bezeichnet. Eines der fruchtbarsten Programme, das vom Projekt durch einen Exposurebesuch in Deutschland und die Organisation einer Untersuchung in Indien vorbereitet wurde, ist aus NABARDs Sicht ein Vorhaben zur Reform des Genossenschaftsbankensektors.

7. Vorschläge für eine zukünftige Zusammenarbeit

NABARD begrüßt die Zusammenarbeit mit der GTZ insbesondere in jenen Bereichen, in denen diese über einen komparativen Erfahrungsvorteil verfügt. Folgende Vorschläge für eine zukünftige Zusammenarbeit wurden vorgelegt:

- Entwicklungspolitisch ausgerichtete Exposurebesuche größerer Gruppen von Entscheidungsträgern in Deutschland und anderen Ländern mit relevanter Erfahrung im ländlichen Finanzwesen
- Hochrangige entwicklungspolitische Seminare in Indien über ausgewählte Themen im Bereich ländliches Finanzwesen
- Fortbildung von Mitarbeitern NABARDs und von Förderorganisationen
- Verbesserungen des MIS
- Förderung eines SHG-Verbandswesens durch Studien, Fortbildung und Ausweitung des Tätigkeitsbereichs der Verbände (*federations*)
- Reform des Genossenschaftsbankwesens durch Exposurebesuche, entwicklungspolitische Seminar und ggf. bilaterale Projekte mit ausgewählten genossenschaftlichen Bankinstituten
- Informationsbesuche, Fortbildung im Rahmen von Exposureprogrammen und Workshops zur Verbesserung des Aufsichtswesens im SHG-Banking
- Tests alternativer Kreditmodelle, z.B. Solidargruppen (*joint liability groups*) nach Vorbild der BAAC/Thailand
- Unterstützung von Finanzprodukten in Gebieten zunehmender Landzersplitterung
- Systematische Untersuchungen über das SHG-Bankingprogramm
- Internationale Verbreitung der indischen SHG-Bankingerfahrung
- Internationale Verbreitung von Informationen über die Mikrofinanzleistungen ländlicher Banken in Indien und ihres Beitrags zu einem *inklusiven Finanzwesen*.

8. Entwicklungszusammenarbeit mit einem Ankerland

Die Entwicklungszusammenarbeit mit Ankerländern wie Indien, die über beträchtliche finanzielle Ressourcen und Planungskapazitäten verfügen, stellt eine neue Herausforderung dar. In unseren Gesprächen ergaben sich tentativ die folgenden Vorschläge:

- (1) Ausrichtung auf Gebiete, in denen Deutschland über einen komparativen Erfahrungsvorteil in Deutschland (z.B. im Bereich der Raiffeisenbanken) oder in Entwicklungsländern verfügt, und Unterstützung durch Kurzzeitexperten in diesen Bereichen
- (2) Förderung des Erfahrungsaustauschs mit Deutschland und relevanten anderen Ländern durch systematisch organisierte Exposurebesuche von Entscheidungsträgern
- (3) Förderung hochrangiger entwicklungspolitischer Dialogveranstaltungen in Indien
- (4) Unterstützung systematischer Forschung in ausgewählten Gebieten
- (5) Direkte technische Zusammenarbeit mit lokalen Institutionen und ihren Netzwerken
- (6) Beteiligung indischer Experten an GTZ-Teams zur Projektentwicklung in anderen Ländern
- (7) Förderung der internationalen Verbreitung indischer Innovationen wie z.B. SHG-Banking
- (8) Erörterung der Durchführbarkeit bilateraler Pilotprojekte in ausgewählten Institutionen wie z.B. Genossenschaftsbanken, ländliche Regionalbanken oder Bankenverbände
- (9) Förderung der Geberkoordination und –kooperation, insbesondere mit FZ-Gebern ohne Landespräsenz zur Steigerung ihrer Effektivität und Zielgruppenerreichung.

1. Introduction

1.1 SHG banking in India: the developing world's largest and fastest-growing microfinance program

SHG banking, or linking banks and self-help groups, in India is the largest and fastest-growing microfinance program in the developing world. Implemented since 1996 on a national scale, it has reached 1.6 million groups¹ with 23.96 million members, covering over 120 million people from the lowest strata of the rural population (as of March 2005). It is a flexible and non-mandatory approach adapted to local conditions by the participating agencies as autonomous business partners. The enormous growth in outreach has been made possible by drawing on a wide array of institutional resources as India's *social capital*: the National Bank for Agriculture and Rural Development (NABARD) as the prime mover and refinancing agency; some 36,000 bank branches and primary cooperatives providing deposit services and credit; some 3,100 governmental and non-governmental agencies with experience in group development as facilitators of previously existing or newly established SHGs; the National Reserve Bank of India which has adjusted the policy framework for banking relations with informal groups; and the political leadership at various state and union levels, prominently providing legitimacy, in the annual union budget statement as an unequivocal expression of the political will.²

At the same time the program has drawn on India's *human capital*: on the one hand the competence and enthusiasm of the staff in all participating agencies, many of which select their staff through competitive exams; and on the other hand the willingness and ability of people from the lowest classes to form a group, meet regularly, pool their miniscule savings, lend to members, and establish a documented track record of financial intermediation within the group. On that basis, the groups are then permitted as informal entities to open savings accounts and obtain bank loans, which they onlend to their members on terms and conditions autonomously decided by each group. In India, as in some neighbouring countries, small groups with financial activities attract predominantly women, even if no such bias is built into the program design: 90% of the group members are women.

Neither social nor human capital would suffice were it not for the *financial capital* created by the program: steadily increasing internal resources of the groups, generated through savings and profits from interest income; and high profitability of SHG banking as a financial product of the banks, due to high repayment rates and low transaction costs of both banks³ and SHGs⁴. SHG banking is viable: for SHGs and banks.

There is strong indicative evidence from a variety of sources that *impact* is deeply felt by the women, the majority of them illiterate: they save, borrow, invest and repay; manage their own SHG affairs, albeit with assistance in bookkeeping; enter banks for financial transactions; contribute to the household economy and improve their standing in the family; send their

¹ Half that number has been credit-linked during the period April 2003 to March 2005, which may serve as an indicator of growth (see Annex 1, Figure 1).

² E. Kropp & B.S. Suran, Linking Banks and Self Help Groups in India—An Assessment. NABARD 2002.

M. Harper, Promotion of Self Help Groups under the SHG Bank Linkage Programme in India—An Assessment. NABARD 2002

H.D. Seibel & S. Khadka, SHG Banking... in India. Savings and Development 26/2 (2002):132-149.

³ H. D. Seibel & H. R. Dave, Commercial Aspects of SHG-Bank Linkage in India. NABARD 2002.

⁴ S. Karduck & H.D. Seibel, Transaction Costs of Self-Help Groups in NABARD's SHG-Bank Linkage Programme: a Study in Karnataka State. NABARD/GTZ 2004

children to school (almost all reportedly do, previously only few did); and for the first time in their life take a positive view of the future.⁵

Impact at the institutional level includes the formation of SHG federations and associations in some states, some of them registered as *Mutually Aided Cooperative Societies* (MACS), a new legal status for financial cooperatives free from government dominance – “based on thrift, self-help and mutual aid and owned, managed and controlled by members for their economic and social betterment”⁶. *Impact at the policy level* includes central bank authorization of financial transactions by banks with informal groups of the lowest economic standing.

All this is just a beginning. *Enormous challenges* remain: reaching out to the remaining 200 million rural poor in India; expanding into states where coverage is still minimal; assuring adequate financial accounting, reporting and control at SHG level as an indispensable basis of financial deepening; finding profitable microenterprise investment opportunities; and making access to financial services sustainable in the long run. In many states SHG banking still has a long way to go – compared to Andhra Pradesh, where government agencies and commercial banks have taken the lead in SHG banking and the rural penetration rate is 50%.⁷

Sustainability of SHG banking in the long run is an unresolved issue. Given the flexibility of SHG banking in India, there may be different routes to the sustainability of access to formal financial services. One is direct access of individuals to bank services through *graduation*, based on the growth of their microenterprise activities and the track record provided by their SHGs; for a transitional period, small-size loans from group funds and opportunities for graduation to larger-size individual bank loans may exist side by side. Another option, presently developing in Andhra Pradesh and neighboring states on a growing scale, is the formation of federations as legal financial intermediaries or business associations, indirectly giving legitimacy to the member-SHGs. A third option presently under discussion may lie in the full integration of credit NGOs and MFIs, with their SHG clientele, into the formal financial sector. The least promising option of sustainability in the long run is the continued existence of informal groups (limited by law to 20 members) with full access to bank services – unless the lawmaker, impressed by their social cohesion and determination to stay together, decides on a new legal status for such groups.

1.2 Results of the impact study phase I the contribution of SHG banking to the Millennium Development Goals (MDGs)

Linking banks and self-help groups has been a major program of German development cooperation since the mid-1980s. In India, within the first 10 years since SHG banking started on a national scale, it has reached about one-third of the rural poor with financial services. It is likely that by the year 2015 it might have reached two-thirds or more of India's rural poor. Given the involvement of GTZ in SHG banking and the unprecedented growth of outreach of that program in India, the German Ministry of Economic Cooperation and Development (BMZ) has proposed to study the impact of SHG banking in India in the framework of the United Nations Millennium Development Goals 2015 on the basis of the

⁵ V. Puhazhendi & K.C. Badatya, Self Help Group Bank Linkage Programme for Rural Poor in India—An Assessment. NABARD 2002

⁶ Andhra Pradesh, Mutually Aided Cooperative Societies (MACS) Act, 1995. From Andhra Pradesh, the act has been spreading to other states.

⁷ Out of 12 million rural families, 7 million are reportedly in the fold of SHGs; 6 million SHGs are credit-linked to banks. In AP SHG banking is close to saturation; repeat loans now amount to 75%. SHGs are rated by the banks as very good clients. In addition, 7 million farmers are covered by individual credit. A total of 1800 training programs have been conducted under NABARD in AP since 1997, currently about 3-400 programs per year.

existing literature; and subsequently to examine the contribution of GTZ on the evolution of the program in India.

At the international level numerous studies have shown that microfinance, while no panacea, has contributed to the achievement of several impact aspects of the Millennium Development Goals (MDG). Despite the existence of a relatively deep and diversified infrastructure of financial institutions the majority of the poorer households and women in rural India did not have access to banks before the start of the SHG banking program. This had led to a low utilization of the potential for income and employment generating activities, with negative consequences on economic growth and the reduction of poverty. Banking with the poor was considered risky and costly. The SHG banking experience has changed all this fundamentally.

The review of impact studies by Hannover⁸ is based on three major sources. Two studies were carried out by the Department of Economic Analysis and Research (DEAR) of NABARD in the years 2000 and 2002, with a focus on impact in terms of income, poverty reduction and several aspects of living conditions of SHG member households. The third impact study was carried out in 2002 by MYRADA, a longstanding NGO partner of NABARD, with a focus on women's empowerment. Overall 865 members of nearly 300 SHGs located in thirteen states participated in the three studies. The results of the impact studies indicate that considerable socio-economic benefits have been accruing to small-scale farming households, rural micro entrepreneurs and the landless. The improved access of SHG members to microfinance services as well as the group approach and related human capacity building processes contribute in several direct and indirect ways to most impact aspects of MDGs 1 to 6. In groups effectively linked to banks at least one basic saving and lending product is generally being offered to SHG members. Most SHG members substantially increase their saving rates. In borrowing patterns a shift has been observed over time from consumption loans to loans for income generating purposes. Increased savings and capital formation improve the self-financing capacities and even out the household's cash flow. This in turn has improved their risk absorption capacity and made them less vulnerable. Access to formal finance has substantially reduced dependency on informal money lenders and has diminished capital costs.

The improved access to financial services has benefited SHG members and their households in maintaining, intensifying and diversifying their economic activities, with positive effects on income and employment generation, especially in the non-agricultural sector. According to the overall study results average net income per household has increased within an average period of about three years by more than Rs. 6,000 or 32% to nearly Rs. 25,000. The share of households living below the poverty line has been reduced from about 50% in the pre-SHG situation to about 31% in the post-SHG situation. Thus, within an average three-year period, nearly 20% of all sample SHG members have raised their income levels above the poverty line (MDG 1). The financial services and their impact on incomes also raise the capacities of SHG members to increase their household expenditure for basic needs such as better nutrition (MDG 1) as well as for education (MDG 2) and health (MDGs 4 to 6).

With about 90% a very high share of microfinance clients of the LBP are women. Membership in SHGs credit-linked to banks contributes substantially to human capacity building and women's empowerment. The women members have become more competent and more self-confident; they also participate more in family decision-making. By creating opportunities for communication and co-operation among group members, SHG membership and active participation in group affairs has improved capacities for problem solving.

⁸ Wolfgang Hannover, Summary of Major Results from Existing Studie on the Impact of the Microfinance Linkage Banking Program in India on the Millennium Development Goals. GTZ, Rural Financial System Development Project, India, Jan. 2005

However, involvement of women, who are mostly illiterate, in local politics is still rudimentary (MDG 3).

Sustainability, or resilience, of the linkage banking approach was found to be well established in many SHGs and can be verified through the better performance of older groups compared to younger ones in the different impact aspects investigated in the studies. There are clear indications that with increasing age of the SHGs performance in terms of poverty reduction continues to improve.

Five major recommendations have resulted from the synopsis of the impact studies:⁹

- (1) More efforts need to be geared towards institution building including the strengthening of group functioning in existing SHGs as well as the promotion of federal structures of SHGs.
- (2) There is a need for the development of more effective management information systems to promote the further consolidation of sustainable financial service delivery through well performing SHGs.
- (3) The future strategy should also focus more on training and capacity building of SHG members as it would improve the productivity of financial service delivery.
- (4) For reducing apparent regional imbalances in linkage banking more emphasis should be put in future strategies on widening the outreach of the programme on the Central and Eastern Regions of the country. To increase the effectiveness such outreach strategies may have to include different delivery models.
- (5) SHGs role in development could be further enhanced through an increased involvement in development programmes in the area.

All five recommendations have been reiterated and confirmed in the discussions held in the mission during March 2005.

1.3 Objectives and conduct of the impact study phase II

The unprecedented scale of SHG banking and its enormous potential for further growth, within India and without, raises the question as to the dynamics of its evolution, of the forces within India behind it, and of the contribution of external organizations. It would be a major historical project to fully investigate the evolution of linkage banking in rural India. In this study we focus on the interaction between NABARD as the driving force in India; APRACA as a regional communication forum and disseminator during an early but crucial phase; and GTZ as a technical assistance agency which first helped develop the concept of linkage banking, then supported pilot-testing and communication on a regional basis, and finally entered into a bilateral assistance project with NABARD.

This is not the story of a development agency with a brilliant idea, planning a project, setting up a project structure from donated resources (or a loan) and, in due course, turning over “the project” to the partner – together with an evaluation report which raises the question of sustainability. Sustainability, development agencies have learned the hard way, will not come unless built into the process from the beginning. The case of SHG banking in India is special: except during the recent phase of rapid expansion, there was no separate donor-financed project; yet, without GTZ’s investment into the linkage approach, the SHG Banking program in India might not have taken off in this form, with such speed and with such outreach. So,

⁹ Wolfgang Hannover, Summary of Major Results from Existing Studie on the Impact of the Microfinance Linkage Banking Program in India on the Millennium Development Goals. GTZ, Rural Financial System Development Project, India, Jan. 2005

how did it start, how did it evolve, and what kept it growing? What has been GTZ's role in the various phases of the evolution of the program? And, with a view to the future: what should be the role of donors and the shape of donor support in an advanced developing country, or *Ankerland* (anchor country), like India?

This study is mainly based on discussions during 11-25 March 2005 with management personnel predominantly of NABARD involved in SHG banking, held in Mumbai, Chennai, Hyderabad and Delhi;¹⁰ and historical documents of GTZ, APRACA and NABARD on the prehistory, concept and evolution of SHG banking.¹¹ Invaluable insights into the origins, pilot testing and mainstreaming of SHG banking in India were gained from in-depth discussions with Mr. Y.C. Nanda and Dr. Prakash Bakshi, the original architect and master builder, respectively, of SHG banking in India. A view of future perspectives of SHG banking in India and of the scope of future collaboration with GTZ was gained from discussions with Madam Rajana Kumar, Chairperson of NABARD, Mr. Y.S.P. Thorat, Managing Director, and Dr. K.G. Karmakar, Executive Director. The author is particularly thankful to Mr. Sukhbir Singh, Chief General Manager, K. Muralidhara Rao, General Manager, Krishan Jindal, Deputy General Manager, Dr. B. S. Suran, Deputy General Manager, and the staff of the Micro Credit Innovations Department (MCID), the management unit at NABARD established for the management and development of the program. Substantive discussions on the design and the results of the study were held with Marie Luise Haberberger, team leader, Jan Meissner, junior expert, and R.V. Ramakrishna, project manager seconded by NABARD, of the GTZ Rural Financial System Development Program, in Delhi.¹² Numerous discussions were held during this mission, also with senior managers from Andhra Bank and Indian Bank.

2. A paradigm shift in rural finance in India and Germany

2.1 Prehistory

The roots of the SHG-Bank Linkage program expand far into the past. An appreciation of the interaction between the Indian and German development partners and the resulting financial innovations would not be complete without a historical perspective. Moreover, the contribution of GTZ can only be assessed within the overall framework of NABARD's own initiatives.

In India, the lack of rural development has been attributed since the 1950s to a lack of production assets among the rural masses and to a lack of access to credit to finance such assets. Private banks that should have provided such credit were absent from rural areas; and informal finance, through moneylenders and rotating *chit* funds, was wholly inadequate. 80% of the population lived in rural areas; 40% of GDP was contributed by agriculture; but only 2.2% of total credit went to agriculture – almost exclusively to medium and big farmers. To remedy the situation, the Union Government of India took three related measures in 1969: the nationalization of 14 private banks (followed by another six in 1980); the requirement to open two rural branches for every urban branch; and a mandatory system of priority sector lending.

¹⁰ This included the two persons with the longest and strongest involvement in the preparation, introduction and mainstreaming of SHG banking in India: Prakash Bakshi, the former managing director of MCID and now in Chennai, who has been involved since 1980; and Yogesh C. Nanda, the former chairman of NABARD, who has been involved since 1990 and took personal responsibility for the adoption of SHG banking in India.

¹¹ The author has been personally involved in the process of developing and pilot-testing the linkage model since the early 1980s.

¹² This program was preceded by the GTZ Linkage Banking Project (team leader: Brigitte Klein), implemented since January 2000. The current program has two components: (i) Linkage banking and (ii) Revitalizing of the Cooperative Credit Structure.

A stocktaking in India in 1975 revealed that as a result of the institutional expansion policy, 10,882 rural and semi-urban branches had been opened; yet the poor still lacked access to credit. It was concluded that rural branches of large commercial banks, be they private or public, are thus not the right answer. Hence, the government introduced a new network of Regional Rural Banks (RRBs), regulated and supervised banking institutions with a low capital base of around \$250,000, each covering with its branches a designated service area of 1-3 districts. Each RRB is owned by government and by a government-owned commercial bank, acting as a sponsor bank and providing the top management, while branch staff, with local knowledge and language skills, comes from the local area. By 2005 there were 196 RRBs with a rural branch network of 14,000, including 12,084 rural and 1,875 semi-urban branches. Yet the problem persisted: RRBs and cooperative banks catered for farmers, not the vast numbers of landless, migrant laborers and illiterate women.

Germany's experience during that period differed widely from that of India. The massive capital transfer through the Marshall Plan led to Germany's economic miracle and its ascendance to the rank of the world's third-largest economy. A government-owned development bank, Kreditanstalt für Wiederaufbau (KfW), played a crucial role in the channelling of investment capital through the banking system. When Germany joined the donor community in the 1960s, KfW turned from recipient to provider of credit lines to an increasing number of government-owned development banks in developing countries.

As in India, private commercial banks were absent in Germany from rural areas well into the 1960s. But unlike in India, two major informal self-help initiatives, one during the second half of the 18th and the other one during the middle of the 19th century, had evolved into a wide network of local banking institutions which now dominate the German banking sector. Among them are the ubiquitous cooperatively-owned Raiffeisen banks, practically one in every but the smallest village, and the community-owned savings banks, both under the banking law since 1934. Through these institutions – self-reliant, viable, sustainable and with outreach of 40,000 branches to virtually the whole population –, German farmers and small and medium entrepreneurs had access to a full range of financial services, including savings and credit. Concerning impact, this has led to a fairly balanced development of urban and rural areas and an economic structure in which 80% of employment is provided by the small and medium enterprise sector.

2.2 Searching for a new approach: from agricultural credit to rural finance

In 1981 the Reserve Bank of India (RBI) carried out the All-India Debt and Investment Survey, published in 1983. After years of massive branch expansion, policies of directing credit to the rural areas, massive self-employment programs, and large numbers of donor credit lines – among them over \$1 billion from the World Bank with the requirement that at least 60% went to small farmers –, a total of 14 million small loans had been provided by banks, yet some 250 million of the rural poor had no access to formal finance, and 39% of rural indebtedness stemmed from informal sources.

At the same time, the German Ministry of Economic Cooperation (BMZ) reviewed its policy of channelling subsidized directed credit through government-owned banks and arrived at comparable conclusions world-wide as RBI did for India. Similar evaluations were carried out by the World Bank, USAID and other agencies – all with results most concisely expressed in a publication by Adams et al. (1984): *Undermining rural development with cheap credit*. Donor agencies and Indian authorities drew opposite conclusions: while BMZ and other donors decided to cut off their credit lines to agricultural development banks, RBI transformed its agricultural credit department into a new apex bank in 1982: the National Bank for Agriculture and Rural Development (NABARD), with responsibility for close to 150,000 rural financial outlets. Yet, the diverging conclusions marked the beginning of a

converging search for a new approach; they also marked the rise of a new agricultural apex bank in search of financial innovations for rural India.

In 1983, the staff of the Economic Analysis and Publications Department (EAPD) of NABARD analysed the data of the 1981 All-India Debt and Investment Survey and concluded that, while India had one of the most complex rural financial infrastructures of any developing country, that system had failed to reach its objectives. Thus resulted the focal question: What is wrong with the system? This became the starting point of NABARD's own research, funded from its own research and development fund and augmented by grant components of ODA and SDC support. Here are some of the findings of the study:

- Procedures of rural banks were complicated and costly. Eg, a loan application form was a 14-page document, requiring the help of informal scribes at the bank's doorsteps.
- The sole emphasis on production loans was ill-guided. Not only is money fungible; the dividing line between production and consumption expenses (eg, for health, education, food) is often purely theoretical.
- Tiny savings exist; but the poor have no opportunity to deposit them.
- Transaction costs were prohibitive, both for the poor and the banks.
- The standardized savings and credit products offered by the banks and their collateral requirements did not meet the needs of the poor. Eg, to lower transaction costs, banks gave loans which were too large for the poor to handle, and frequently timed to the convenience of the bank and not the borrower.

NABARD realized that programs with the poor have to be **savings-led** and not credit-driven; and that the poor have to have a say in their design. In the years to come they looked for new partners, new delivery systems and new financial products. One of these new partners was MYRADA, an NGO in south India, whose action research into *credit management groups* during 1985-88 was funded by NABARD jointly with CIDA. The study was based on a new paradigm: savings first – seen by NABARD as a departure from the microcredit world! Three options were discussed, all hinging on prior savings mobilization by the groups: matching grants, matching interest-free loans, or loans with interest. In search for a sustainable solution, NABARD opted for the latter.

3. Linking banks and self-help groups: a rural finance innovation

Around the middle of the 1980s, in both India and Germany, as in the international development community¹³, there were thus notable beginnings of a paradigm change in rural finance. The emerging paradigm had two major aspects: financially, bringing together savings and credit as the two sides of any dynamic financial intermediation process; organizationally, bringing together government agencies, including government banks, with the private sector, particularly NGOs as facilitators and SHGs as grassroots organizations. In that way, the ground was prepared for a major rural finance innovation in which self-help groups would first mobilize their own resources through equity contributions and savings, transform these funds into loans to their members at self-determined terms and conditions and then, on the basis of their track record, get access to banks or other financial institutions, particularly for credit but also for other financial services including deposits.

In actual fact, the linkage model evolved initially in India and Germany in parallel. In India it evolved out of the action research project of NABARD and NGOs with what was called at the time *credit management groups*, but lacked an analytical concept and an eye-catching term. In

¹³ Eg, the emphasis on savings mobilization and on “the links between the institutional sector and the non-institutional sector” were also at the center of attention in the United Nations Symposium on *Savings for Development*, Yaoundé, Cameroon, December 1984 (published in 1986).

Germany, the actual development of the linkage model, which subsequently became a brand name, resulted from different inputs by researchers and German bilateral technical assistance. The researchers, building on a wide variety of earlier studies of SHGs and informal finance, suggested programs of upgrading SHGs as an indigenous basis of financial sector development, with the objective of improving their operations, adopting an appropriate legal status, forming networks and federations with services for their member organizations, and integrating them into the national financial system.¹⁴ GTZ however, as a governmental organization, found itself unable to work directly and exclusively with private institutions and suggested public banks, such as agricultural development banks and central banks, as partners, which in turn may link up with other financial institutions including private and rural banks. It was this compromise between researchers and bilateral TA which led to *linking banks and self-help groups* as a hybrid model.¹⁵ While *linkage banking* (a term introduced in 1989) was designated as a linkage model, it was meant to also incorporate aspects of two other approaches: *upgrading self-help groups* as informal financial institutions and *downgrading banks*¹⁶, the latter term adopted from the debate on appropriate technology in the late 1970s.

In Germany 1983 marks the reorientation of financial sector development policy. A newly unit in the ministry, ES31, brought together three worlds of development: government agencies including GTZ and KfW, a wide variety of NGOs, and research institutions. The new communication forum was backed by a parliamentary development policy commission favorably inclined to the emerging new concept of rural finance, encompassing savings and credit of both farmers and microentrepreneurs (variously called the informal sector or the crafts and small trade sector) instead of agricultural credit; and the inclusion of a variety of institutions, both governmental and non-governmental.¹⁷ While KfW and GTZ had hitherto only worked with government agencies in the developing countries, they now met with new partners: NGOs and SHGs¹⁸. One of the immediate results of this new coming together was a ministry-financed research program mobilizing the intellectual resources of research institutes: on such topics as savings mobilization, SHGs and informal finance, including basic research on formal and nonformal finance.¹⁹ It was found that SHGs acting as financial

¹⁴ H. D. Seibel: Indigenous Economic Cooperation and its Developmental Function in Liberia. Cooperative Information (ILO, Geneva) 3/1970:7-53;

H. D. Seibel & U. Damachi: Self-Help Organizations: Guidelines and Case Studies for Development Planners and Field Workers, a Participative Approach. Friedrich-Ebert-Stiftung, Bonn 1982

¹⁵ H. D. Seibel & M. T. Marx: Linking Formal and Informal Financial Institutions: Indigenous Savings and Credit Associations as Credit Groups. In: United Nations, Third International Symposium on the Mobilization of Personal Savings in Developing Countries 1984, Yaounde, Kamerun.

H. D. Seibel: Saving for Development. A Linkage Model for Informal and Formal Financial Markets. Quarterly Journal of International Agriculture, Vol. 24, No. 4, Oct. - Dec. 1985, pp. 390-398.

¹⁶ The term has now been largely replaced by *downscaling*, which is not quite appropriate as it emphasizes the quantitative aspect only and ignores the qualitative aspect (in the sense of simpler and more down-to-earth financial technologies and delivery systems).

¹⁷ While mentioning names does injustice to those unnamed, there are three whose interaction turned out to be seminal: Karl Osner at the ministry, Erhard Kropp at GTZ and Winfried Pinger at the Development Policy Commission of the parliament.

¹⁸ The concept of self-help groups (*Selbsthilfegruppen*) was not new in Germany. In fact it dates back at least to the origins of the savings and credit groups (*Darlehnskassenvereine*) of the emerging cooperative movement around 1850. What was new was their recognition as an important instrument of either self-organization or the mobilization of large numbers of people hitherto out of reach of government organizations. It was not always clear to the NGO community whether this should be welcomed or regarded as an intrusion on NGO turf.

¹⁹ Kirsch, Armbruster & Kochendörfer-Lucius, Selbsthilfereinrichtungen in der Dritten Welt (Self-help institutions in the Third World). Forschungsberichte des Bundesministeriums für Wirtschaftliche Zusammenarbeit 49, Weltforum Verlag, Köln 1983.

H. D. Seibel: Ansatzmöglichkeiten für die Mobilisierung von Sparkapital zur Entwicklungsfinanzierung: Genossenschaften und autochthone Spar- und Kreditvereine in Nigeria (Savings mobilization for development: cooperatives and indigenous savings and credit associations in Nigeria).

intermediaries were widespread throughout the developing world, though there were large differences in form, density and outreach. They were either of indigenous origin or introduced by governmental or nongovernmental organizations. Those SHGs which were of indigenous origin typically were self-reliant in terms resource mobilization and management, viable and, as a socioeconomic institution embedded into local law and culture, sustainable. In some countries, the institution in the form of rotating savings and credit associations had been in existence for centuries.²⁰

In 1985 GTZ decided to carry out feasibility studies of linkages between banks and self-help groups. The first set of studies was carried out in Africa²¹, where financial self-help groups were found in abundance, but no banking partners²². This was communicated to both FAO and APRACA and led to a proposal for feasibility studies of SHG-bank linkages in Asia presented by APRACA²³ at the SACRED III Consultation held by FAO in Rome during 17-22 September 1985 and submitted by H.J. Mittendorf of FAO to Karl Osner of BMZ for financial support.²⁴

4. The emergence of SHG banking in India

4.1 The APRACA workshop in Nanjing: a trigger event

The decisive event which brought the linkage approach to the attention of policymakers and banks in Asia was the APRACA regional workshop²⁵ in Nanjing, China, in May 1986,²⁶ on “Strengthening Institutional Credit Services to Low-income Groups”. At this workshop GTZ, through Dr. Erhard Kropp, presented the linkage model, building on the existing formal and nonformal financial infrastructure, with the following elements: SHGs as informal financial intermediaries; savings-based credit linkages with banks; informal groups holding savings and credit accounts in banks; NGOs (SHPIs) as social, and initially also financial, intermediaries; flexible models of cooperation between SHGs, NGOs and banks as autonomous business partners, each with its own existing financial and institutional

Forschungsberichte des Bundesministeriums für Wirtschaftliche Zusammenarbeit 63, Weltforum Verlag, Köln 1984.

H. D. Seibel & M. T. Marx: Dual Financial Markets in Africa: Case Studies of Linkages between Informal and Formal Financial Institutions. Verlag Breitenbach, Saarbrücken 1987.

²⁰ Eg, in China (*hu*), India (*chit*), Korea (*kye*) and Nigeria (*esusu*) (Seibel 1982)

²¹ H. D. Seibel: Ländliche Selbsthilfeorganisationen in der Volksrepublik Kongo unter besonderer Berücksichtigung der Ansatzmöglichkeiten für eine Verknüpfung informeller und formeller Selbsthilfeorganisationen mit der Entwicklungsbank CNCA (Rural self-help organizations in the People's Republic of Congo: linking informal and formal self-help organizations with CNCA (Caisse Nationale du Crédit Agricole). GTZ, Eschborn 1986

H. D. Seibel: Einheimische Selbsthilfeorganisationen im ländlichen Raum in der Republik Elfenbeinküste unter besonderer Berücksichtigung der Ansatzmöglichkeiten für eine Verknüpfung informeller und formeller Finanzinstitutionen (Indigenous self-help organizations in rural areas: linking informal and formal financial institutions in Ivory Coast). GTZ, Eschborn 1986.

Seibel et al. 1986.

²² In Congo-Brazzaville, the newly established CNCA had a repayment rate of 4%. In Ivory Coast, a project proposal had been prepared with BNDA, but the bank collapsed shortly thereafter as a result of a major fraud.

²³ The project proposal, *A Study on Transaction Costs in Linking Formal and Informal Rural Financial Institutions*, refers to an earlier study based on south-south academic cooperation and the involvement of a German NGO: H.D. Seibel & Ukandi G. Damachi, *Self-Help Organizations: Guidelines and Case Studies for Development Planners and Field Workers*. Friedrich-Ebert-Stiftung, Bonn 1982

²⁴ Ref. PR 16/2 Germany IL 32/201, Oct. 8, 1985.

²⁵ In cooperation with the Asian NGO Coalition, FAO/RAPA, UN-ESCAP and the Agricultural Bank of China.

²⁶ Report on the TCDC Workshop on Strengthening Institutional Credit Services to Low-Income Groups. Nanjing, China 26-30 May 1986. Apraca Report No. 18.

resources. To facilitate communication between these business partners and initiate linkages, he suggested pilot projects, possibly with German bilateral assistance.

The workshop in Nanjing brought together for the first time, at the regional level, high level government development finance institutions, NGOs, and donor agencies to discuss ways in promoting formal and informal group linkages on the issue of rural credit and savings mobilization. This initiative generated follow-up activities involving the conduct of country level surveys to map out existing successful and innovative self-help credit and savings schemes and to study possibilities of institutional linkages between development financial institutions and self-help groups.²⁷ *Linking Banks and Self-Help Groups* was subsequently adopted by APRACA as its main program²⁸ at the Sixth General Assembly in Kathmandu, December 1986, and supported by a GTZ sector project over a ten-year period.

In NABARD's view, the Nanjing workshop had a **trigger effect** on the adoption of SHG Banking in India. However, this effect could not have taken place had the ground not been prepared in India by various agencies, among them MYRADA, Sewa Bank, PRADAN and numerous other NGOs and MFIs. Again, many subsequent events took place in parallel creating linkage experience at local and national levels and the exchange of experience at international level through APRACA. During the first half of 1987 feasibility studies were carried out with GTZ support in Indonesia, Philippines and Thailand and concluded in each country with a national workshop. In Indonesia, Bank Indonesia as the central bank, together with Bank Rakyat Indonesia as the government's agricultural bank and Bina Swadaya as a prominent NGO which had represented Indonesia in Nanjing, decided to adopt the approach in a pilot project. In July 1987, upon the conclusion of a second feasibility study in Indonesia, they invited the participants of the 17th Executive Committee Meeting of APRACA to a field visit of SHGs, with the objective of examining the potential of bank linkages at the grassroots level. Dr. P.D. Ojha, the Deputy Governor of the Reserve Bank of India, and Mr. M.S. Yadava of the State Bank of India were among the participants. The feasibility studies and resulting guidelines for a flexible linkage model to be adjusted to the circumstances in each country was presented in 1987 at the 10th Foundation Anniversary of APRACA in New Delhi²⁹ and published in 1989.³⁰ Under Governor G.B. Thapa, Chairman of Apraca, and Benjamin Quinones as APRACA's secretary-general as its chief regional promoter, *Linking Banks and Self-Help Groups* was subsequently adopted by APRACA as its main program.

4.2 A study of SHGs in India

In India, in a meeting of the APRACA member institutions held in February 1987 in Bombay, it was decided that, "in pursuance of a recommendation made by APRACA", a task force and study team led by NABARD³¹ would carry out a field study of some 50-60 SHGs and their savings and credit activities. NABARD reports that GTZ³² participated in the designing of the study. At this workshop GTZ presented the linkage model, jointly developed by Erhard Kropp

²⁷ E. T. Valenzuela, Executive Secretary of the Asian NGO Coalition, July 1987, in a proposal addressed to Benjamin R. Quinones Jr, Secretary-General of APRACA.

²⁸ "Promote linkage between banking institutions and *Self-Help Groups* in rural savings mobilization and credit delivery to the rural poor. (APRACA Report, April 1987, p. 32)

²⁹ H.D.Seibel, The APRACA Program of Linkages between Banks and Self-Help Groups

³⁰ E. Kropp, M. T. Marx, B. Pramod, B. R. Quinones & H.D. Seibel: Linking Self-help Groups and Banks in Developing Countries. Eschborn, GTZ; Bangkok, APRACA, Rossdorf, TZ-Verlag, 1989

³¹ The study team comprised representatives of NABARD, State Bank of India, National Co-operative Agriculture and Rural Development Banks' Federation, National Federation of State Co-operative Banks Ltd., National Institute of Bank Management, and Centre for International Co-operation and Training in Agricultural Banking. C. Ramalingam, head of EAPD at NABARD, was the leader of the team, together with Prakash Bakshi, E.S. Patole and 14 others.

³² Through Dr. Erhard Kropp.

and Hans Dieter Seibel. Building on the existing formal and nonformal financial infrastructure, the model contained the following key elements:

- (i) to understand the background of the emergence of self-help groups, their composition, methods of working and their linkages with the financial institutions, and
- (ii) to examine possibilities for development of linkages between the self-help groups, self-help promotion institutions and the financial institutions for providing support to the self-help initiatives of rural development.³³

The study was carried out in 1987 and published in 1989.³⁴ To identify SHGs, the team approached 175 NGOs, 30 answered, five of them were involved in the promotion of savings and credit activities. SHGs without any link to an NGO, including the ubiquitous chit funds, were thus not included in the study. Almost all the groups were of recent origin, emphasized self-help, were largely (but not invariably!) homogeneous in terms of caste and activity, built a common fund from very small regular savings and interest income, and lent to their members for periods of 1-3 months at 2-3% interest per month. Recovery of these loans was excellent, and an impact, however small, was felt, reaching from emergency assistance to release from bonded labor. While the groups preferred to remain informal, they shared basic features of formal bodies in terms of bookkeeping and management. Access to formal credit was virtually nonexistent. NGOs reportedly had “played a commendable role in organising the rural poor into self-help groups and thereafter promoting their proper functioning.” Given the very low resource base of internally generated savings on the one hand and some notable exceptions of “effectively developed credit links between the target groups and banks”, the team thought it “desirable to consider development of flexible models of linkages appropriate for various situations” and asked “what types of pilot or action-research projects need to be developed for evolving appropriate linkage models?”³⁵

4.3 Towards a pilot project

At the time when the team in India carried out the SHG study, 1988, a pilot project did start, but not in India but in Indonesia, with technical assistance from GTZ.³⁶ Under the auspices of the central bank, Bank Indonesia (BI), and with increasingly strong participation from banks and NGOs, PHBK, the Indonesian acronym for *Project Linking Banks and SHGs*, became APRACA’s and GTZ’s first experimental station for linkage banking in Asia. The General Manager of the Development Policy Dept. of NABARD, Mr. Y.C. Nanda (later: Chairman of NABARD), was among those visiting the project and participating in field visits in 1989 and 1990.³⁷ The delegates from India as well as from other countries learned that the central bank of Indonesia had authorized its public and private banks to accept informal groups as customers and lend to them without insistence on physical collateral; and that repayment rates during the pilot phase were close to 100%.

Intensely monitored and reported upon at APRACA meetings and international conventions, it attracted widespread attention, among others by the president of the World Bank, who

³³ NABARD, *Studies on Self-Help Groups of the Rural Poor*. Bombay 1989, p. 3.

³⁴ NABARD, *Studies on Self-Help Groups of The Rural Poor*. Published on behalf of the Indian member institutions of APRACA and with a publication grant from APRACA. Bombay, NABARD.

³⁵ NABARD, *Studies on Self-Help Groups of the Rural Poor*. 1989: 53-58

³⁶ At the same time preparations were under way for pilot projects in the Philippines and in Thailand.

³⁷ Mr. Nanda played a key role in the SHG banking program in India. He had come to Bombay in 1990 as secretary to the board of NABARD and joined DPD-NFS at the turn of the year 1990/91. As a member of a task force, which included the managing director and the chairman of NABARD, on accelerating credit flows in dryland areas, he searched for innovations and found them in SHGs and SHG banking. From thereon he handled the SHG dialog and took personal responsibility for the pilot project and the mainstreaming of the program. In 1993 he attended a GTZ policy workshop on rural finance in Germany.

wrote, somewhat optimistically, in the foreword of the World Development Report 1989: “Informal financial institutions have proved able to serve the household, agricultural, and microenterprise sectors on a sustained basis. Measures that link informal institutions to the formal financial system will improve that service and ensure a competitive environment.”³⁸ APRACA member institutions, including NABARD, felt inspired.

Reviewing the situation of rural finance in India again in 1989, it was observed that most of the 196 Regional Rural Banks (RRBs) were loss-making and thus did not present a viable solution. This led to a discussion in parliament about the feasibility of a Grameen Bank, following the model of Bangladesh, as a new national banking structure. On the basis of its own studies and also inspired by the linkage experience under APRACA, NABARD instead argued for a different approach with the following elements: using the existing infrastructure of banks and social organizations; it should be savings- rather than credit-led; and using bank rather than donor resources in the provision of credit.

Between 1989 and 1991, NABARD’s Development Policy Department Non-Farm Sector (DPD-NFS) entered into a policy dialogue with the Reserve Bank of India (RBI) to make preparations for a pilot project linking informal groups to banks.³⁹ In a workshop in Pune in 1991, NABARD (through Mr. Nanda and Mr. Bakshi) encouraged hesitant senior bankers to participate in the program. Building on the guidelines of the Indonesian project, DPD-NFS revised them and prepared draft guidelines of its own for a pilot linkage project. On that basis and with reference to studies by NABARD, APRACA and ILO, RBI issued a circular⁴⁰ on 24 July 1991 to commercial banks advising them to actively participate in the pilot project, refinanced by NABARD, for linking SHGs with banks. The groups may be registered or unregistered, have 10-20 members, should have been in existence for at least six months, and should have actively promoted the savings habit. Further details of the pilot scheme were to be evolved by NABARD in consultation with the banks and voluntary agencies (VAs, NGOs).

Just before the finalization of the guidelines, APRACA held a *Regional Consultation on the Guiding Principles for Linkage Programme* in Indonesia, January 13-17, 1992. There were five participants from India; a pilot project proposal was presented by Mr. Nanda, who became the promoter of SHG banking in India. The workshop proceeded in four steps: summarizing the experience from India, Indonesia, Nepal, Philippines, Sri Lanka and Thailand; presenting draft guidelines; submitting them to a validation process in the field by working groups; and revising the guidelines in a participatory process.⁴¹

5. SHG banking in India: from pilot project to mainstreaming

5.1 The start-up phase

This led to a final revision of NABARD’s own guidelines⁴² and a circular to all commercial banks, dated 26 February 1992⁴³, announcing the start of a pilot project of linkages between SHGs and banks, to be refinanced by NABARD. There were considerable doubts in the banking community about the chances of uncollateralized lending to the poor, which the

³⁸ World Development Report 1989: Financial Systems and Development. NY, OUP 1989: iv, 119

³⁹ Cf. NABARD Annual Report 1990-91, chapter on: *Credit Needs of the Rural Poor – Role of Self Help Groups and their Linkages with Formal Credit Institutions*.

⁴⁰ Ref. RPCD.No.Plan.BC.13/PL-09-22/90-91

⁴¹ On the basis of the results, a training manual was subsequently prepared and published: H. D. Seibel, *Self-Help Groups as Financial Intermediaries: A Training Manual for Self-Help Groups, Banks and NGOs*. Saarbrücken, Verlag Breitenbach Publishers, 1992.

⁴² Y.C. Nanda, *Promotion of Linkages between Self Help Groups of the Poor and Formal Credit Institutions*. NABARD, 1992

⁴³ Ref. No. NB. DPD. FS 4631/92-A91-92, signed by Y.C. Nanda.

then-chairman of NABARD and deputy governor of RBI, P. R. Nayak, together with Mr. Nanda, had to dispel. The objectives of the pilot project were given as follows:

- i. to evolve supplementary credit strategies for meeting the credit needs of the poor by combining the flexibility, sensitivity and responsiveness of the informal credit system with the strength of technical and administrative capabilities and financial resource of the formal credit institutions;
- ii. to build mutual trust and confidence between the bankers and the rural poor;
- iii. to encourage banking activity, both on the thrift as well as credit sides, in a segment of the population that the formal financial institutions usually find difficult to cover.

The SHG-Bank Linkage pilot project was initially scheduled to cover some 500 SHGs in 11 Indian states during a two-year period, 1992-94. The pilot phase was extended until 31 March 1995, “(to be) followed by a two years experimental phase.”⁴⁴ At the beginning of the pilot phase, the banks noted a contradiction between a directive of the RBI of 27 December 1985, which restricted the opening of savings accounts, and the circulars of RBI and NABARD authorizing bank linkages of informal groups: did the SHG banking circulars allow for savings accounts or just credit? This was finally decided in a circular⁴⁵ by RBI on January 4, 1993: “... such Self-Help Groups, registered or unregistered, may be allowed to open Savings Bank Accounts with banks.”

At mid-term, March 1994, 637 SHGs (80% women’s groups) with 11,000 members, most of them women, had been credit-linked to 28 banks, comprising 16 commercial and 12 regional rural banks. 34 NGOs were involved as facilitators. Large numbers of officers of NABARD were sent to MYRADA and other NGOs for exposure training. It was predictable that the pilot project would exceed its quantitative objectives by a wide margin. In fact, by March 1996, 4,757 SHGs with 80,000 members had been mobilized by 127 NGOs and credit-linked to 95 banks. (Table 1)

Table 1: SHG-Bank Linkage program in India: the pilot phase, 1992-1996 (as of March, end of fiscal year)

	1993	1994	1996
SHGs credit-linked	255	637	4,757
% women’s groups	70	80	74
No. of members	5,100	11,000	80,000
Banks	14	28	95
SHPI partners	32	34	127

Source: NABARD

5.2 A mid-term evaluation, 1994

NABARD evaluated the project in three states – Karnataka, Andhra Pradesh and Tamil Nadu – and found that the program was highly suitable for poor and very poor women particularly in marginal, resource-poor areas; membership has come mostly from the poorest section of the society; women frequently need credit, but at irregular intervals; they use the loans for productive and non-productive purposes, with a trend towards productive investments; incomes have gone up; even the poorest of the poor do save, and their savings increase with the income; transaction costs of banks and SHG members go down; the repayment rate is close to 100%, in contrast to the usual rate of 50-60% in agricultural credit. In comparison to the Grameen Bank model, NABARD found that “the SHG linkage model appears more sustainable and appropriate in the Indian conditions where (India has) in

⁴⁴ NABARD, NABARD-GTZ Collaboration Draft Proposal for TA, p. 8

⁴⁵ Ref. DBOD.No.BC.63/13:01:08/92-93.

place a vast network of rural bank branches... (and) SHGs which are functioning on their own and waiting to be linked to the banking system.”⁴⁶

5.3 Mainstreaming SHG banking

During 1994-96 RBI instituted a task force headed by the general manager of NABARD, Mr. S.K. Kalia. Its task was to examine operational issues faced by banks and assess the program, with the expectation of mainstreaming if found effective. The findings were presented in 1996. It was decided to spread the program nationwide; and a circular was issued to that end, which clarified two issues: SHG members who had earlier defaulted on bank loans and were therefore not bankable could obtain loans from the groups' own internal funds; informal groups were limited to 20 members, beyond which they would be required to register under some law.

Capacity building in the participating institutions was considered the main challenge: a need that had been identified in the GTZ organized ZOPP workshop of 1994. For capacity building and innovations NABARD established in 1996 a Credit and Financial Services Fund from its own resources, with assistance from SDC. The only supplementary donor funds available for capacity building during that period were from SDC, originally earmarked to the non-farm sector and re-allocated upon the request of Mr. Nanda to the SHG-Bank Linkage program. The Fund enabled NABARD in 1997, ie, five years after the start of the pilot project, to design the first systematic capacity training program in SHG banking, prepared in cooperation with its partners at the Bankers Institute of Rural Development (BIRD) in Lucknow and disseminated through a circular.

In 1998, NABARD carved the Micro Credit Innovations Department (MCID) out of DPD-NFS as the program steering unit, with representations in all states through a Micro Credit Innovations Cell (MCIC). At the same time, SHG banking was declared the dominant approach of lending to the poor, replacing bank retail lending. Personally directed by Mr. Kotaiah as chairman and Mr. Nanda as executive director, and with the board's directive in mind to stay away from small projects, MCID formulated NABARD's *grand vision of one million SHGs*, representing a population of 100 million of the rural poor, to be credit-linked by the year 2008: a vision endorsed by NABARD's regional directors and subsequently articulated by union government. Since 1998 SHG banking has been pronounced as a non-mandatory program in all budget statements and assured the refinancing of the participating banks by NABARD. Media exposure was initially restricted, for fear of politicisation before the program was strong enough. The number of SHGs credit-linked to banks grew to 33,000 in 1999 and 115,000 in 2000.

Capacity building has been the motor that drove the further progress of the program. In May 2000 NABARD held a three-day training consultation at BIRD with banks, NGOs and senior government administrators, preparing six training packages for different audiences, available on NABARD's website⁴⁷. Program dissemination and capacity building expanded rapidly in the following years, reaching the goal of one million credit-linked SHGs for 2008 by the turn of the year 2003/04 and 1.6 million SHGs by March 2005. (Table 2)

⁴⁶ NABARD, NABARD-GTZ collaboration: Draft Proposal for Technical Assistance, 1994, pp. 5-6. Y.C.Nanda, Country Report India. APRACA-GTZ Regional Workshop on the Linkage Programme, 1995.

⁴⁷ <http://www.NABARD.org/roles/microfinance/>

Table 2: Mainstreaming SHG banking in India, 1996-2005 (as of March, end of fiscal year)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
SHGs credit-linked ⁴⁸	4,757			32,995	114,775	263,825	461,478	717,360	1,079,091	1,597,804
% women's groups	74			84	85	90	90	90	90	90
Members in millions	0.08			0.56	1.9	4.5	7.8	11.6	16.7	23.96
Banks	95			202	266	314	444	505	560	
Bank branches							17,085	30,942	35,294	35,294
SHPI partners	127				718	1,030	2,155	2,800	3,024	3,024
Bank loans disbursed (Rs bn) ⁴⁹				0.57	1.93	4.81	10.26	20.49	39.04	68
NABARD refinance to banks (Rs billion)				0.52	1.50	4.01	7.97	14.19	21.25	30.92
NABARD refin. in % of bank loans disbursed				91.2	77.7	83.4	77.7	69.3	54.4	45.5

Source: NABARD

6. GTZ's role in SHG banking in India

6.1 Planning for GTZ support to NABARD's SHG-Bank Linkage program

Through APRACA, communication with other member institutions and GTZ-supported bilateral projects was maintained; documentation of linkage experience in member countries was widely circulated. The initial success of the pilot project, its acceptance by both banks and NGOs and the strong backing by RBI⁵⁰ led NABARD to consider mainstreaming SHG banking throughout the rural banking sector of India and to request technical assistance from Germany⁵¹.

On 31 August to 2 September 1994, a ZOPP workshop with representatives from NABARD, banks and NGOs was held in Bombay for the planning of a bilateral project during the latter part of the pilot project and the transition to mainstreaming at national level. NABARD in its proposal formulated the project objective as follows:

The overall objective of the project is to develop an innovative, supplementary and self sustaining credit delivery model for improving the access of rural poor to credit and in the process improve the outreach of the formal banking system and also enhance the quality of credit in the rural areas. The project would promote greater people's participation, self-help and establishment of grassroots institutions.⁵²

⁴⁸ Cumulative data; there is no information on groups that may have dropped out of credit linkages, either because of self-reliance on their own resources or because of dissolution.

⁴⁹ No information is available on the amount of loans outstanding. There is also no information on average loans to members, which are financed from own SHG resources and bank loans. In a small sample study in 2004, SHGs with an average age between three and four years had an average portfolio of loans outstanding to members of Rs 100,800, 53% of which was financed from internal resources and 47% from bank resources. Two thirds (64%) of the internal resources were generated from savings and one-third (36%) from retained earnings. (S. Karduck & H. D. Seibel, Transaction Costs of Self-Help Groups in NABARD's SHG-Bank Linkage Programme: a Study in Karnataka State. NABARD & GTZ, 2004)

⁵⁰ In a circular dated 8 March 1994, RBI reconfirmed its backing and requested the commercial banks to percolate the instructions regarding the linkage program to the branch level, identify the NGOs and the SHGs organized by them in their areas of operation, adopt a positive and constructive approach in financing NGOs and SHGs, and attend special workshops and awareness programs.

⁵¹ NABARD, Request for Training and Technical Assistance from the FRG and its agencies like GTZ/KfW, draft 2002. A formal request for TA was submitted on 31.03.1994 (GTZ Stellungnahme to BMZ, 6.6.1994)

⁵² NABARD, NABARD-GTZ collaboration: Draft Proposal for Technical Assistance, 1994. Or in the words of the GTZ proposal: "Banken und Selbsthilfegruppen werden gestärkt als lokale Finanzintermediäre der ländlichen Armen als Sparer und Kreditnehmer. Damit werden gleichzeitig die direkte Beteiligung der Bevölkerung, Selbsthilfe, einheimische Institutionen und

The main emphasis of the bilateral project was to be on capacity building of SHGs, NGOs and banks, geared to the establishment of viable and sustainable linkages between banks and SHGs. Other results to be attained included the development of appropriate financial instruments, the establishment of a MIS and the promotion of a policy dialogue on financial liberalisation. GTZ support was planned for a three-year period, July 1995 to June 1998, to be preceded by preparatory support starting in October 1994. GTZ was to provide a financial contribution (grant) of DM 3.5 million, comprising DM 3.0 million for capacity building abroad and DM 0.5 million for training and data processing equipment; plus 24 person/months for international short-term experts. NABARD was to provide the equivalent of DM 32.5 million for bank credit lines, DM 5 million for capacity building (excluding personnel expenses) and 36 person/months for national short-term experts.

Initially, NABARD saw the main value of GTZ support in well-organized exposure visits abroad, including in Germany, for numbers of decision-makers and managers from NABARD, banks and NGOs. The bulk of all resources was to be provided by NABARD and the banks. GTZ support was to be ancillary, both in financial and management terms:

- *With regard to finance*, NABARD stated: "The linkage project and other credit innovations are already underway and funding arrangements for the same has been firmed up and therefore, an India component amounting to nearly Rs. 750 million would be taken care of by NABARD".⁵³
- *With regard to management*, reflecting the participatory will of the ZOPP workshop, the proposal states that NABARD provides the project management.⁵⁴

In line with its strong interest in strengthening its own management and planning capacity, NABARD was impressed by the ZOPP experience during the planning workshop, which it found very appropriate for an apex institution like NABARD:

"There could be exposure in GTZ for a few senior executives to be followed up by detailed training on the methodology and familiarisation of about 10-15 operational officers and 8-10 trainers attached to the training centres of NABARD. These exposure and training programmes would help in gradual internalisation of the ZOPP technique in NABARD..., the Bankers Institute of Rural Development... (and) the trainers of banks..."⁵⁵

6.2 The decision-making process

As stated in the Project Progress Review of March 2003, "implementation of the NABARD-GTZ cooperation began with considerable delays".⁵⁶ At the ZOPP workshop in 1994, NABARD had made it clear that it welcomed support for training and exposure abroad as well as short-term expert services. It did not require any donor credit lines to refinance the participating banks. NABARD also decided to manage the program from within and to establish its own management unit, the Micro Credit Innovation Department (MCID).

Nichtregierungsorganisationen gefördert. "(GTZ & NABARD, Vorschlag für ein bilaterales Projekt der TZ: Stärkung lokaler Finanzintermediation von Selbsthilfegruppen und Banken zur Armutsbekämpfung in Indien, Sept. 1994)

⁵³ NABARD, NABARD-GTZ Collaboration Draft Proposal for TA, p. 16

⁵⁴ "Der Partner stellt das Projektmanagement; ein deutscher Teamleiter ist nicht vorgesehen." (GTZ & NABARD, Vorschlag für ein bilaterales Projekt der TZ, p. 10)

⁵⁵ NABARD, NABARD-GTZ Collaboration Draft Proposal for TA, p. 13

⁵⁶ "Substantial activities were only started from phase 2 onwards which has a duration from January 2001 to the end of 2003. The focus of the co-operation is on the further development/promotion of sustainable innovative solutions for rural finance/linkage banking and related contributions to concept and strategy development." GTZ, Project Progress Review, March 2003, p. 1.

Workshop participants had agreed that the management of the SHG-Bank Linkage program rested with NABARD.

GTZ subsequently submitted to NABARD a proposal for a bilateral project with a long-term expert.⁵⁷ This came at a precarious time and was not immediately accepted by the board, which had general objections against small experimental projects and voiced doubts over the prospects of uncollateralized lending to informal groups.⁵⁸ It was only after prolonged negotiations and living proof that SHG banking was no longer a small project of a doubtful future that a bilateral project was signed in 1998 and took off in 2000. The project was based in Delhi and worked on a relatively open agenda. In fact, the project entered into a dialog on cooperative reform, a field where Germany excels in terms of historical comparative advantage, organized exposure visits and policy seminars and finally, in 2005, adopted “Revitalizing of the Cooperative Credit Structure” as its second component, welcomed by NABARD with great fervor. This in turn has been instrumental in strengthening the role of cooperative banks and primaries (PACS) in SHG banking.

6.3 GTZ’s historical contribution to SHG banking in India

The main contribution of GTZ to SHG banking in India is seen by NABARD’s management in generic inputs during the preparatory phase, approximately 1986-1994, followed by specific inputs during the maturity phase of the program since 2000. The following are seen as seminal inputs during the preparatory phase:

- Conceptual development of the linkage model by GTZ and its presentation at the APRACA workshop in Nanjing, with a trigger effect on NABARD’s own search for a new approach in rural finance
- Providing a framework for a study of SHGs in India by a consortium of Indian institutions under the leadership of NABARD as part of a regional initiative preparatory of linkage pilot projects
- Preparation and initial test of operational procedures of linkage banking through a bilateral project in Indonesia, which provided a tested outline for the first phase of the pilot project in India
- Participation in, and continual support for, APRACA’s program Linking Banks and Self-Help Groups, providing a regional communication forum for the exchange of experience.

Through these inputs, GTZ contributed to a self-sustaining evolutionary process of SHG banking in India, fully owned and managed by NABARD and its partners within India. SHG-Bank Linkage has reportedly changed the image of NABARD. At all levels, from the rural poor to the highest policymakers, it has reportedly earned NABARD the reputation of a bank which very effectively and efficiently cares for those previously thought unbankable. Within NABARD, MCID, in charge of SHG banking, has become a preferred department from a career viewpoint. The vigor and diversity of *SHG banking*, the Indian brand of linkage banking, may precisely be due to the fact that all external inputs remained just that: external inputs, which were kept at a distance. They were adopted and modified by Indian institutions as seen fit, but not replicated in any mechanical manner. The scene was set in 1987 by the way the SHG survey was conducted in India: not by a foreign consultant but by a consortium

⁵⁷ At the same time, there were also negotiations with SDC on support for technical assistance; SDC funds originally earmarked for the non-farm sector were subsequently extended upon NABARD’s request to SHG banking.

⁵⁸ In this atmosphere, the board decided to bar any bilateral project with its long-term staff from NABARD’s premises. Two major arguments were reportedly voiced: First, accommodating many small TA projects is cumbersome and absorbs too much attention from management and staff. Second, it was felt that once an important program is supported by foreign technical assistance, international attention shifts to the donor; and innovations and impact are mainly attributed to the donor.

of Indian institutions, which subsequently declared ownership over the evolving new approach to rural finance.

As important as these inputs may have been, they would not have led far without the leadership of NABARD and its top management, the political will at state and union levels, the policy support of the central bank, and the commitment and determination of large numbers of bank, NGO and government partners. In India, **the generation of the political will** behind the linkage program has been a purely internal process.

It is impossible to attribute the enormous volume of internal resource mobilization within the self-help groups, the volume of bank refinance, the involvement of large numbers of self-help promoting institutions, and the impact all this has had on the lives of a hundred million people of very low social and economic standing in a precise way to specific forces, agencies and persons. Questioned about his personal impact on the program, a leading NABARD manager stated:

“Difficult to answer. It is an inclusive kind of program, not depending on the mind of a single person.”

And with regard to the role of GTZ, he and others found it equally difficult to give a precise answer:

“In 2000 the program was eight years old; GTZ’s contribution is difficult to pinpoint.”
“Could we have done all these things without GTZ and SDC? Support by two international agencies has given NABARD a lot of freedom to do things – vis-à-vis the board, the government and RBI. This made it possible for the officers of the MCID to perform better. There would have been much less expansion and success without these two organizations: financial support from SDC, technical inputs by GTZ.”

The Swiss Development Corporation (SDC) and GTZ are frequently mentioned as two equally important contributors and commended for their support to financing experimentation. Reference is made to SDC as the agency which helped NABARD to establish its Credit and Financial Services Fund for capacity building and innovations. But experimentation remains a critical area for which external input is required.

6.4 GTZ’s ongoing contribution to SHG banking and rural financial system development

Since 2000, during the maturity phase of the program, GTZ has supported a bilateral *Linkage Banking Project*. By expanding its scope, this was followed in 2005 by a second phase, entitled *Rural Financial System Development Program*, with the objective of enhancing the quality and viability of financial services in a sustainable way. The program has two components: support to *Linkage Banking* and *Revitalizing of the Co-operative Credit Structure*, which comprises some 115,000 rural retail outlets. The latter component had its roots in the phase I project, where initiatives were taken building on a strong comparative advantage of Germany in rural and cooperative banking experience. It links up with the German Cooperative and Raiffeisen Confederation (DGRV) on one hand and other donor agencies on the other hand, particularly the Asian Development Bank. The two components are linked in that cooperative banks were the weakest participants among the rural banks in SHG banking; and their role, together with that of the primary cooperatives (PACS) under their authority, is now being strengthened not only in the linkage program but also as an integral part of the rural financial infrastructure. This is of particular importance to NABARD, to which the Reserve Bank of India (RBI) has delegated the authority of supervising both the rural cooperative banks and the regional rural banks. What has been remarkable in this partnership is the ability of NABARD and the willingness of GTZ to depart from a given framework of bilateral cooperation and to expand into broader and innovative approaches to rural financial sector development.

What has been most important to NABARD in this phase is the flexibility of support in fields in which it would have had difficulty getting approval for the use of its own resources:

“Support by two international agencies, SDC and GTZ, has given NABARD a lot of freedom to experiment – vis-à-vis the board, government and RBI. There would have been much less expansion and success without these two organizations. SDC and GTZ have allowed us flexibility and given us a free hand – a wonderful thing.”

Of particular value during the last four years has been GTZ’s support to intellectual dialogue, exposure abroad, and special studies. Here are some initiatives commended by NABARD in our discussions:

- Exposure visits to Germany and related studies have helped preparing the ground for cooperative sector reform and a bilateral project component.
- Exposure visits to Bank Rakyat Indonesia, one of the most successful microfinance providers in the developing world, and the BKD village banking system in Indonesia have broadened perspectives on microfinance.
- Exposure visits to Uganda as well as Indonesia, with a focus on regulation and supervision, have opened new perspectives on how to supervise institutions with small accounts and small institutions.
- An exposure visit to Bolivia, which also included a focus on regulation and supervision, has demonstrated the usefulness of smart cards as a device to improve financial transparency and reduce transaction costs and is now being pilot tested by NABARD.
- Among the studies financed by GTZ is a study of demand-led savings products, which includes life, health and accident insurance. This study is cited as particularly important. It was found that flexible, accessible and secure savings and micro insurance facilities are considered as important as loans, particularly by more vulnerable people. It is expected that once 10-15 million SHG members are covered by group health insurance, premiums will go down substantially.
- The studies presented at the tenth anniversary of SHG-Bank Linkage program in India in October 2002, with support from GTZ, IFAD and SDC, have enabled NABARD to subject the strengths and weaknesses of the program to external scrutiny and have provided a basis for the international dissemination of the approach.
- Among these studies is a study of bank transaction costs in SHG banking, designed by GTZ and NABARD and co-financed by GTZ and IFAD. This provided indicative evidence of the profitability of SHG banking and inspired the chairman of the association of commercial banks to encourage its members to further expand and deepen their services to SHGs. This in turn contributed to the subsequent surge of credit linkages of SHG.
- A study of SHG transaction costs supported by GTZ in 2004 indicated that the gains of banks were not due to a shift in transaction costs to SHGs, among which real and opportunity costs of bank linkages were found to be minimal. SHG banking has proven to be convenient and profitable for banks, SHGs and members.
- Various contributions have been made to NABARD’s management information system (MIS) of SHG banking; its improvement on different levels is an ongoing concern of SHGs, banks, promoting institutions and NABARD.
- Staff members of NABARD joined several international training events, like the GTZ courses in financial system development in Thailand and Sri Lanka and the microbanking training of Bankakademie⁵⁹.

⁵⁹ The GTZ Project Progress Review of March 2003 (p. 45) arrived at the following overall assessment: “after a decade of implementation of the SHG-banking approach, NABARD has been able to increase the outreach of banking in rural India very substantially... The German contribution to the Linkage Program was started in several important fields as for example MIS and savings mobilization. The utilization of (these) project outputs and services ... are generally still at the

- GTZ has supported the South-South dialogue between NABARD and other GTZ projects and programs, which has included information visits of high-level delegations.

7. Expected future collaboration⁶⁰

There are several fields where NABARD realizes that GTZ has a strong comparative advantage, based on its own historical experience, which complements the historical experience and comparative advantage of NABARD. There is a wide range of suggestions concerning the future scope of collaboration with GTZ. This chapter is based on suggestions as voiced in the discussions. They may present a basis for further discussion and feasibility studies as seen fit.

(1) Rural finance policy dialogue, exposure visits and capacity building

NABARD is open for a thorough fresh review of “what we did and what shall be done; there is no need for incremental knowledge. Wipe the board clean and look at it again.” Moreover, “the world has paid too much attention to microfinance, ignoring banks as providers of rural credit. We have to go back to rural credit, but not to its past bias in favor of big farmers.... It has been the genius of NABARD to take the state credit system and link it to SHGs.” NABARD recognizes the contribution of GTZ to SHG banking and KfW to the Indo-German watershed program over an extended period of time: “a determined effort to push the poor over the poverty line with credit.... rigor, system, methods and controls” are regarded as exemplary. In this vein, there are three related fields where the need for support by GTZ is most strongly felt by our discussants:

- High-level policy seminars in India on selected topics in rural finance
- Policy-oriented exposure visits on selected topics (*see below*) to countries with relevant experience in rural finance including Germany, involving large numbers of policy- and decision makers for short periods of time and smaller numbers for extended periods of time⁶¹
- Capacity building of staff at NABARD and facilitating institutions such as NGOs (as trainers of SHGs), government agencies and banks, including training in MIS development and dissemination to all levels

(2) Relevant Management Information

Several suggestions were made to GTZ to support studies, publications and presentations at international conferences:

- GTZ is asked to further contribute to improvements in the MIS, including information on loans outstanding (instead of disbursements and cumulative reporting), NPA and repeat loans.

beginning. Most visible up to now are the positive effects of the supported training programme on capacity building in the participating organizations.”

⁶⁰ Suggestions not dealt with in further detail in this chapter include the following: commodity finance including warehouse receipts and short-term trader finance; agro-processing; rural energy; rain water harvesting; agricultural producer markets; crop insurance; interventions in the northeast; rural planning; Rural Knowledge Centers.

⁶¹ Mr. Nanda sees a strong need for repeated visits of larger numbers for shorter periods of time. Mr. Thorat stresses the importance of exposure training of small groups of NABARD managers for periods of 2-3 months in Germany and 2 months in Indonesia (BI supervision over BPR, BRI supervision over their units) or the Philippines for in-depth studies of an “implementable supervisory framework”, to be followed by a 10 day workshop to work out the framework; this may lead to a pilot project, possibly supported by GTZ and KfW. Ms. Kumar emphasizes the importance of a major coordinated project, as the logistics of support of different donors for different areas are difficult to implement.

- The monitoring system reports only SHGs which are credit-linked. It is suggested to also include information on the number of SHGs which are only savings-linked to banks.
- Most existing studies are local, small-scale, and cross-sectional. It is suggested to GTZ to support more research of SHG banking on a broader scale, including longitudinal studies. As a first step, this would require a joint review and planning of studies, using perhaps the advanced ZOPP and AMPS (advanced multi-stakeholder planning system) methodology in which GTZ has sponsored several training workshops.
- International awareness of the Indian SHG banking experience is not commensurate to its actual outreach and growth. It is suggested to GTZ to continue contributing to the international dissemination of SHG banking in India, as GTZ did in the past through the APRACA LBS program, and to attract international researchers, perhaps with their own funding. GTZ may also negotiate with research foundations (eg, Ford, Volkswagen) the establishment of rural finance research areas. At the same time, NABARD may revitalize the dissemination of SHG banking with the support of GTZ worldwide.
- GTZ is also asked to spread the message in the microfinance community that RRBs and other rural banks in India are MFIs, thus widening the scope of international attention.
- In this context, GTZ may also assist in presenting SHG banking as a major contribution to *inclusive finance*, a new term which might eventually supplant older terms such as microfinance, rural finance and development finance⁶².
- Contrary to the assumption of “the eternal Indian village”, land fragmentation and the consolidation of fragmented land are future challenges to which rural finance must respond. GTZ may support research and round table discussions on patterns and products of rural lending to cope with land fragmentation.

(3) Developing SHG federations:

as financial intermediaries or promoters of microenterprises and marketing

Federation formation is an ongoing process which this consultant first observed in Andhra Pradesh in February 2000 and regarded as a giant step towards self-reliance and sustainability, based on *felt needs* and initiatives *from below*.⁶³ Meanwhile however, others were equally impressed, as our discussants pointed out; and donors, among them the World Bank, have promoted federations *from above*.⁶⁴ This has raised fears in NABARD that this may pervert the process; and it warns against politicization and imposition “from above”. NABARD, as a bank of banks, on principle favors bank linkages over a process of upgrading which would integrate informal SHGs into federations. But NABARD states that it first of all tolerates, and then in due course supports, whatever works in India. In Andhra Pradesh (AP) NABARD studied 18 SHG federations/MACS/MFIs during 2001. This led to the establishment by the government of AP of a working group,⁶⁵ which brought together “RBI, NABARD, Government of AP, banks and other microfinance practitioners for cementing

⁶² UNCDF, Building Inclusive Financial Sectors for Development: a Global Meeting Shaping the „Blue Book”, Geneva, May 4-5, 2005

⁶³ They may register under various legal forms, among them MACS, a new legal status for autonomous cooperatives which is being enacted in an increasing number of states.

H. D. Seibel & Shyam Khadka, SHG-Bank Linkage: A Financial Technology for Reaching Marginal Areas and the Very Poor: NABARD’s program of promoting local financial intermediaries owned and managed by the rural poor in India. IFAD Rural Finance Working Paper A-9, 2001; published in: *Savings and Development* (Milan) 26/2 (2002): 132-149.

⁶⁴ The merits and constraints of federating SHGs have been recently explored, and some actions to address these constraints discussed. (Ajai Nair, Sustainability of microfinance self help group in India: would federating help? World Bank Policy Research Working Paper WPS3516, March 2005.

⁶⁵ Government Order No. 625 dated April 19, 2002

credit linkages with SHG Federations,” and prepared guidelines for the financing of federations in 2003.⁶⁶

There are two types of federations, and in a number of cases two types of functions of a given federation, with a differentiated development potential:

- (i) financial intermediation, accepting deposits from SHGs or individuals and providing loans (with upstream linkages to banks);
- (ii) non-financial activities, such as microenterprise skill training, product development and marketing among its member SHGs to attain scale and value-added quality.

Federations registered as financial cooperatives with the status of *Mutually Aided Cooperative Societies* (MACS), may eventually either replace banks by establishing direct linkages between themselves and their member SHGs, or become a new link in the chain between SHGs and banks. Federations with purely non-financial functions would not directly impact on the financial relations between SHGs and banks.

SHG banking is not only a banking product; it also has become a mass movement with its own dynamics. With sustainability in mind, NABARD considers its own role as well as the role of NGOs as temporary. Ultimately, SHGs as grassroots financial intermediaries will have to decide for themselves whether to link up with banks or with federations as quasi-banks; or to link with banks for financial and federations for non-financial purposes. In either case, NABARD considers it as an act of SHG empowerment to let them decide for themselves. This would permit NGOs to withdraw and focus on the establishment of new groups and the spreading of outreach of the program to new areas.

Federation formation is still a gray area where NABARD invites assistance by GTZ:

- assisting NABARD in setting up a training system for federation staff, including the training of auditors.
- connecting with GTZ's ongoing projects of skill and market awareness training in India, creating synergies, perhaps with an emphasis on value-adding processing, standardization, packaging and quality control.

(4) Reforming cooperative finance

India is seen as equipped with a strong rural financial sector, where bank failures have been absent. However, commercial banks and partly RRBs are efficient; cooperative banks require a lot of attention towards reforms. One of the most fruitful studies and exposure visits in the eyes of NABARD is a spin-off of the bilateral SHG-Bank Linkage project: a study of the German cooperative rural banking system and the contribution made by GTZ to a program of reforming the cooperative banking sector in India. This has resulted in a revamping of the project as of 2005, with a second component devoted to the restructuring the cooperative banking sector, including primary cooperatives (PACS), which is considered of key importance in rural financial system development. Special emphasis is being placed on the testing of different models of regulation and supervision (including self-regulation and delegated supervision), liquidity exchange, deposit insurance in PACS, product development (eg, programmable smart cards vs. magnetic cards), computerization and capacity building.⁶⁷

It is pointed out that one-off studies and exposure visits are not enough. To generate a lasting impact, continuity is essential.

⁶⁶ Working Group on Guidelines for Financing SHG Federations/MACS/MFIs: Summary of Recommendations. NABARD, Hyderabad, May 2003, p. 3

⁶⁷ Report of the Task Force on Revival of Cooperative Credit Institutions December 30, 2004, Chairman: Prof.A.Vaidyanathan

- It has been suggested that groups of 10-12 policy- and decisionmakers “should go to Germany over and over again” to study cooperative rural finance, with particular emphasis on appropriate regulation and effective supervision.
- It is further suggested to GTZ to call for a high-level seminar in India, reporting on the German model (with a branch network of 20,000 and a share of 23% in total banking assets) “so that those people who matter see what is possible in the cooperative sector”.
- GTZ is also asked to contribute to MIS and technology upgrading in cooperative banking

(5) Establishing an appropriate supervisory framework

NABARD recognizes that world-wide in developing countries there is too much emphasis on regulation and too little on effective supervision. Bank supervision in India includes only large accounts; small accounts of banks remain largely unsupervised. By implication, this means that institutions with a focus on small accounts, such as RRBs and cooperatives, suffer from a lack of supervision; and so do the small accounts themselves, such as those of SHGs. NABARD suggests support for the preparation and pilot-testing of an “implementable supervisory framework” for banks, which includes small institutions and the much-ignored small accounts (eg, of SHGs) in any institution. The following steps have been recommended:

- exposure training of small groups of NABARD and bank managers for periods of 2-3 months in Germany;
- exposure training of NABARD and bank managers for two months in Indonesia, to study BI supervision over BPR and BRI supervision over its units, or in the Philippines or other suitable countries;
- followed by a 10 day workshop to work out the framework;
- a pilot project, possibly supported by GTZ and KfW.

(6) Testing alternative delivery models

Credit delivery through joint liability groups, which do not function as financial intermediaries of their own, has been the preferred approach of BAAC in Thailand, where GTZ has been involved with TA. Initial steps have been taken:

- To test the feasibility of joint liability group lending by RRBs as an alternative mode of credit delivery, as practiced by BAAC/Thailand.
- To support exposure visits of NABARD executive directors to Thailand.

8. Development cooperation with an *Ankerland* (anchor country)

Planning capacities and financial resources in an *Ankerland* (anchor country) exceed those in less developed countries by a wide margin. This creates a particular challenge for technical assistance agencies like GTZ, which has traditionally provided human and financial resources to offset shortcomings in planning and innovation capacities. Ours is not a systematic exploration of new ways of cooperating with a country like India. However, there are several conclusions that may be drawn from the cooperation of Germany and India in the field of rural finance over the past ten years and from the discussions held in the course of this study.

NABARD does not favor conventional technical assistance projects placed within the organization. It welcomes “foreign experts as advisers, but not as implementers”. This is to be seen in the framework of India’s policy of accepting ODA only from the EU, France, Germany, Japan, UK and the US; all other countries have to work through NGOs under the Ministry of Home Affairs. Concerns have been expressed that small projects absorb too much management capacity and, at the same time, direct an undue share of international attention to the donor in the attribution of success. In fact, there is little, if any, evidence of an

overall lack of planning and innovation capacities within an organization like NABARD, and the Micro Credit Innovations Department in particular. However, there are other shortcomings in large bureaucratic organizations which reduce their ability to make full use of their human and institutional capacities, particularly in areas where synergies and perhaps even paradigmatic breakthroughs may be gained from the interaction with experts and innovative experiences in other countries. In fact, reversing the perspective, one of the leading NABARD managers considers “Germany as an anchor country through which we learn from 120 countries.” A number of tentative suggestions have emerged from our discussions:

- (1) Focus on areas where Germany has a comparative advantage of experience within Germany (eg, cooperative banking in the Raiffeisen tradition) or in the developing world.
- (2) Facilitate the exchange of experience with relevant other countries (including Germany) through systematically organized exposure visits of policy- and decision-makers⁶⁸
- (3) Support high-level policy dialogue in India⁶⁹
- (4) Support systematic research on selected topics, involving national and international researchers
- (5) Promote the international dissemination of innovations from India such as SHG banking, including the exchange of experience between India and other countries. This may include support for the transformation of the International Visitors Program into a commercially operating profit center, offering consultancy services in areas where NABARD has domain knowledge and organizing exposure and apprenticeship training in agencies like NABARD, banks and NGOs.
- (6) Include Indian experts in GTZ teams designing projects in other countries, with the expected dual effect of disseminating the experience of India and taking a fresh look at their own country
- (7) Discuss with our partners the feasibility of bilateral pilot projects in key institutions such as selected cooperative or regional rural banks or banking associations
- (8) Promote donor coordination, collaboration and co-financing as seen fit, including bilateral donors like DFID, GTZ and SDC; multilateral donors like IFAD, UNDP and World Bank; and international donors like CARE and CRS⁷⁰ - spreading SHG banking “as an add-on to all projects”. GTZ may have a special role to place in cooperating with financial assistance donors without a field presence; this might greatly increase the effectiveness of financial assistance donors and of GTZ’s depth of outreach.

⁶⁸ The information visits of high level decision-makers of Government of India, Reserve Bank of India, NABARD and cooperative banks for a study of the German cooperative system in 2001 and the subsequent study in 2002 by German cooperative experts of the cooperative system of India may be cited as a model case.

⁶⁹ A rural finance policy workshop organized by NABARD and supported by GTZ is scheduled for May 2005.

⁷⁰ These are the donors mentioned by NABARD as cooperating agencies.

Annex 1: Quantitative results of impact study phase I⁷¹

Figure 1: Number of SHGs linked to banks per year in the LBP

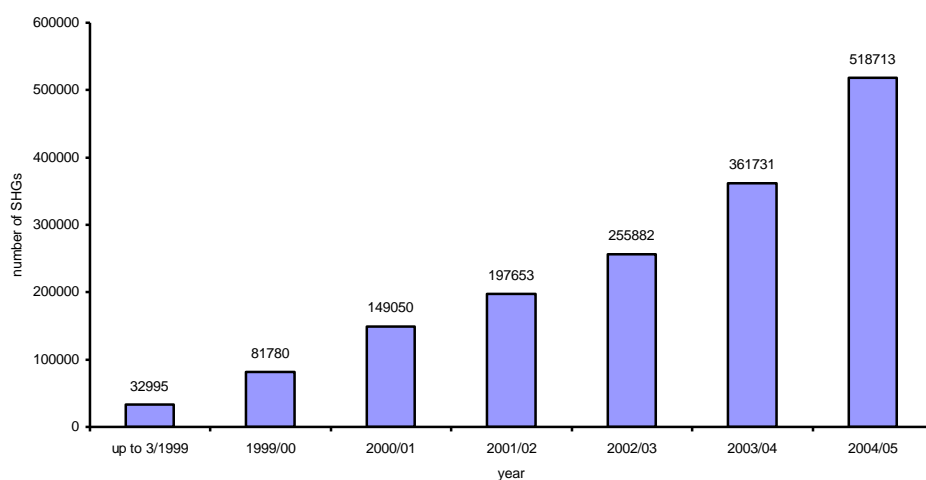
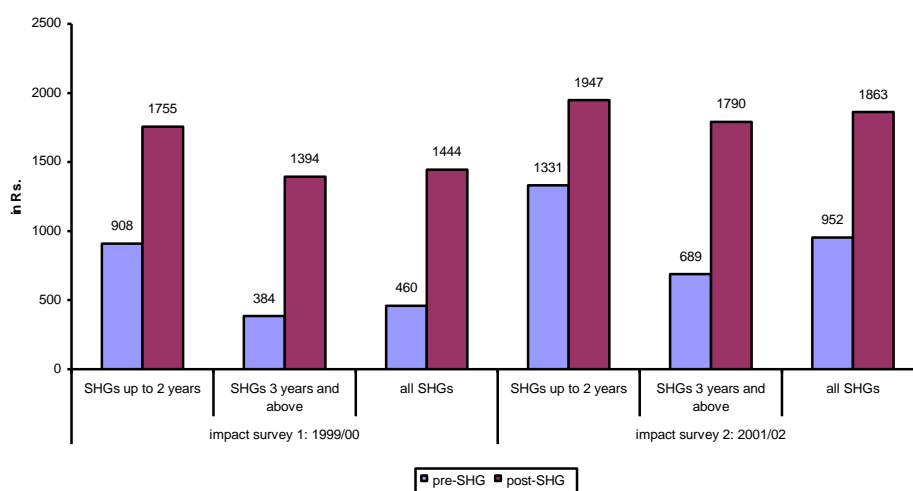


Figure 2: Changes in the average savings/year per sample SHG member household according to SHG age



⁷¹ W. Hannover, Summary of Major Results from Existing Studies on the Impact of the Microfinance Linkage Banking Program in India on the Millennium Development Goals.. GTZ, Eschborn, Jan. 2005. Figure 1 adjusted for column 2004/05.

Figure 3: Changes in average loan amounts per sample SHG member household according to SHG age

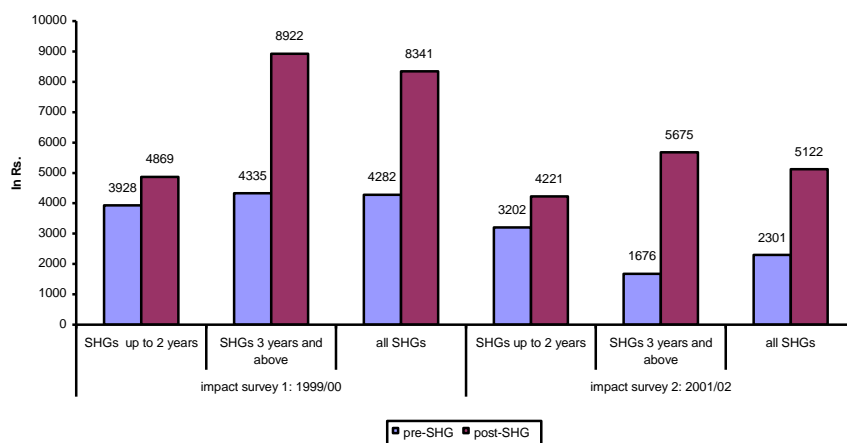


Figure 4: Changes in the average value of assets per sample SHG member household according to SHG age

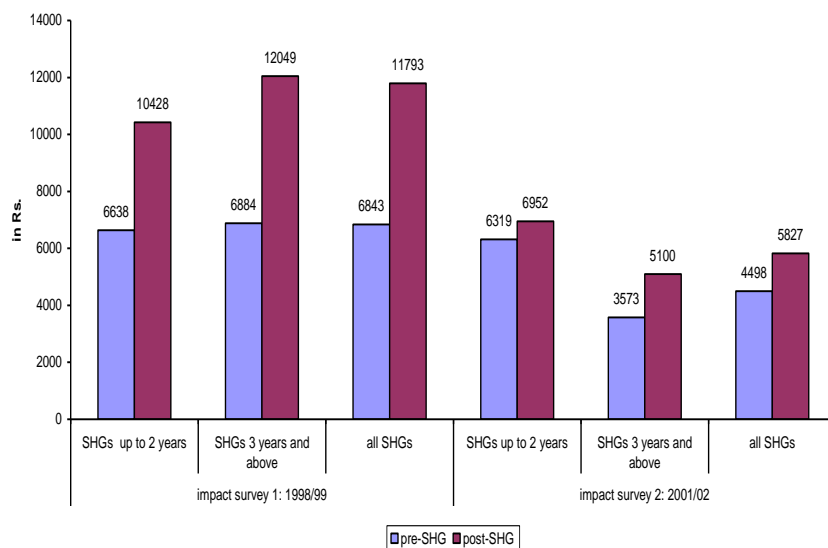


Figure 5: Changes in average net incomes per sample SHG member household according to SHG age

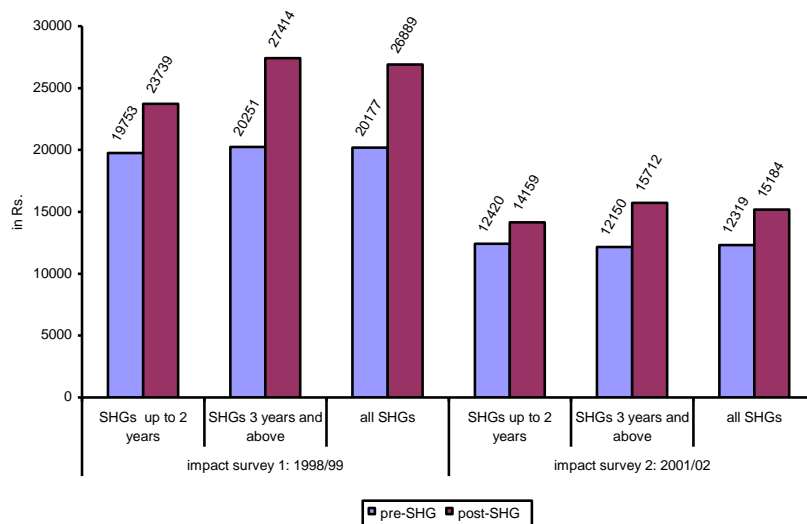


Figure 6: Changes in average net incomes per sample SHG member household by SHG promotional model

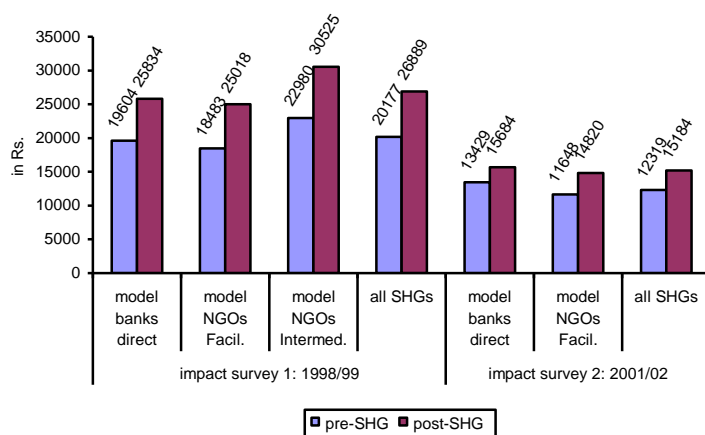


Figure 7: Changes in the share (%) of sample SHG member households living below the poverty line

