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Theme 211  
MICRO FINANCE  
PART I

A monthly publication from South Indian Bank



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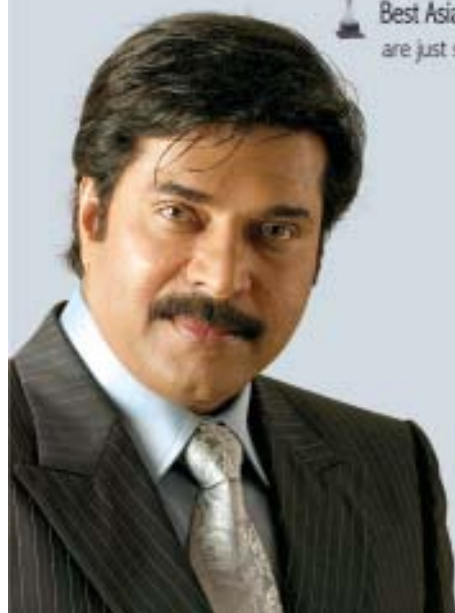
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Theme No. 211 : MICRO FINANCE - PART I

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The term 'micro-finance' denotes provision of financial services to the poor and includes micro-credit, micro-insurance and micro-savings. The best example of microfinance has been provided by Nobel Laureate Muhammad Yunus in Bangladesh. What is now known as the Grameen Bank got started with an experiment by Prof. Yunus in 1976 to lend his own money to the poor villagers of Jobra, gradually transforming them into small entrepreneurs. Owing to some innovations like group guarantees provided by cooperatives of small entrepreneurs, and the support of various organizations including the Ford Foundation and the governments of Sweden, Bangladesh, Norway and the Netherlands, the institution has grown to serve 7.4 million borrowers. The Grameen model has been replicated successfully throughout the world.

The success was fuelled by international movements to propagate microfinance. In 1995, the World Bank decided to set up a Consultative Group to assist the poor that included donations from several financial institutions and national governments.

The Microfinance Summit of 1997, with over 1,500 organizations from 137 countries pledged to reach, through microfinance, 100 million poor families globally. The summit highlighted that microfinance would be sustainable without continuous subsidies.

According to the Microcredit Summit Campaign (Microcapital, 2009), 3,552 microfinance institutions (a broad term that includes a diverse set of micro-credit providers like cooperatives, associations, rural banks, etc.) reached over 154 million clients by end 2007, thus meeting the objective defined in 1997. In 2002, only 67.6 million clients were reached by such institutions.

India has witnessed tremendous progress in microfinancing during the recent years. There is a surge in the investor interest and there has been a phenomenal growth in the number of Micro-Finance Institutions (MFIs).

There are many new entrants into the sector like private and multinational banks, private equity and venture capital funds, wholesale fund providers, rating agencies, international retail institutions, etc. The sector has exhibited exponential growth during the last five years. The banking sector has been able to reach approximately 59 million households through SHGs (Self Help Groups) and approximately 9 million other households have been covered by MFIs in the country.

Despite this, microfinance has penetrated only 15 percent of the estimated demand. According to a survey done by Sa-Dhan, the apex body of MFIs in the country, microfinance is likely to have a client base of 300-400 million in the coming decade.

### **What is microfinance?**

Microfinance means providing very poor families with very small loans (micro-credit) to help them engage in productive activities or develop tiny business. Over time, micro-finance has come to include a broader range of services (credit, savings, insurance, etc.) as the poor and the very poor who lack access to traditional formal financial institutions require a variety of financial products.

The Task Force on Supportive Policy and Regulatory Framework for Micro finance has stated in its report, “Despite having a wide network of rural bank branches in the country and implementation of many credit-linked poverty alleviation programmes, a large number of the very poor continue to remain outside the fold of the formal banking system. Various studies suggested that the existing policies, systems and procedures and the saving and loan products often did not meet the needs of the hard-core and asset-less poor”. The poor are provided the hassle free finance at proper time through the formation of SHGs. The SHGs are considered the best way to provide the credit to the people who require it the most, whereby the advantage percolates down exactly to the needy. SHGs have been providing the last-mile link between banks and the unbanked or the under-banked. In the November mid-term review of 2005-06 monetary and credit policy, the RBI commented- “The programme of linking SHGs with the banking system continues to be the major micro finance programme in the country, and is being implemented by commercial banks, RRBs and cooperative banks”.

### **What is meant by a Self Help Group (SHG)?**

SHG is a small, homogenous affinity group of rural poor-agricultural laborers, marginal and small farmers and micro-enterprises which is voluntarily formed. It can be formal or informal. SHGs are formed by the members, for the members and of the members.

They are encouraged to practice voluntary thrift on a regular basis. The SHG has generally a minimum of 5 members and not exceeding 20 members. Members save and contribute to common fund from which small loans are met to the needy member as per the decisions of the group.

### **What are the goals of SHGs?**

Self-Help Groups are generally started by non-profit organizations (NGOs) that generally have broad anti-poverty agendas. Self-Help Groups are seen as instruments for a variety of goals including empowering women, developing leadership abilities among poor people, increasing school enrolments, improving nutrition and the use of birth control. Financial intermediation is generally seen more as an entry point to these other goals, rather than as a primary objective.

### **What are the advantages of financing through SHGs?**

An economically poor individual gains strength as part of a group. Besides, financing through SHGs reduces transaction costs for both lenders and borrowers. While lenders have to handle only a single SHG account instead of a large number of small-sized individual accounts, borrowers as part of an SHG cut down expenses on travel (to & from the branch and other places) for completing paper work and on the loss of workdays in canvassing for loans.

### **What are the different models of linkage between SHGs and Banks?**

There are three models of linkage between SHGs and Banks.

- i) Banks deal directly with the individual SHGs. The banks provide financial assistance to individual SHGs for lending to individual members.
- ii) SHGs formed by NGOs or Government agencies and linked to Bank.

In this, NGOs, would organize the poor into SHGs, undertake training, help in arranging inputs, extension and marketing, introduce saving and internal lending and help in maintenance of accounts and so on. Banks directly provide loans to SHGs, with recommendation of NGOs.


iii) Linkage of Micro Finance Institutions (MFIs) with the banking sector: The MFI-Bank linkage model too has assumed importance on account of credit support extended by banks for on lending to clients by MFIs.

Among the three models, majority of the SHGs belonged to model (ii) above. The programme has registered significant growth both in terms of coverage and outreach to the poor. During the year 2007-08, 5, 52,992 new SHGs (excluding SGSY) were credit linked with banks and bank loan of Rs.2541.98 crores were disbursed. The cumulative number of SHGs credit linked as on 31<sup>st</sup> March, 2008 is 40.85 lacs. The total loan amount disbursed is Rs.22, 196 crores which works out to Rs.54, 335- per SHG. NABARD provided refinance of Rs.7062 crores accounting for 31.8 per cent of total disbursements. The programme has covered more than 5.8 crore poor households, making it the largest micro-finance programme in the world.

### **What is the repayment history of loans given to SHGs?**

Out of the 290 reporting banks, 107 banks (37 per cent) reported recovery of more than 95 per cent of the loans disbursed to SHGs in India as on March 31, 2008. This was followed by 80 to 94 per cent recovery performance reported by 105 banks (36 percent). Only 20 banks consisting of 5 RRBs and 15 cooperative banks reported less than 50 per cent recovery from SHGs. This indicates that the overall recovery performance from loans to SHGs was satisfactory.

### **What is the role of ‘Kudumbashree’ in promoting SHGs in Kerala?**

Kudumbashree, poverty Eradication Mission of Kerala, was set up in 1998 under the aegis of the State Government and the NABARD. Kerala now boasts of lakhs of SHGs, locally known as ‘ayalkoottam’, comprising mostly women from the lower strata of the society. Aided by the credit scheme, there are thousands of individuals and group enterprises that run canteens, catering units, group farming, soap making, book making and various other income generating activities. Kudumbashree is rated as one of the best models in poverty eradication through microcredit in urban and rural areas. 

**“An individual poor person is an isolated island by himself and herself. Micro-credit can end that isolation.”**

## **Microfinance - An effective poverty reduction strategy**

Microfinance is often considered one of the most effective and flexible strategies in the fight against global poverty. It can be implemented on the massive scale necessary to respond to the urgent needs of those living on less than \$1 a day, the World's poorest.

Microfinance consists of making small loans to individuals, usually women, to establish or expand a small, self-sustaining business.

An equally important part of microfinance is the recycling of funds. As loans are repaid, usually in six months to a year, they are re-loaned. This continual reinvestment multiplies the impact of each dollar loaned.

Microfinance has a positive impact far beyond the individual client. The vast majority of the loans go to women because studies have shown that women are more likely to reinvest their earnings in the business and in their families. As families cross the poverty line and micro-businesses expand, their communities benefit.

Prof. Muhammad Yunus & the Grameen Bank, Bangladesh founded by him were awarded The Nobel Peace Prize for 2006 for their efforts to create economic and social development 'from below' with the means of Micro credit. The Grameen Bank has been a source of ideas and models for the many institutions in the field of micro-credit that have sprung up around the world.

“Microcredit is a critical anti-poverty tool - a wise investment in human capital. When the poorest, especially women, receive credit, they become economic actors with power - Power to improve not only their own lives but, in a widening circle of impact, the lives of their families, their communities, and their nations.” - UN

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*Your comments and feedback on this publication may be sent to Staff Training College, The South Indian Bank Ltd., Thrissur 680 001 or by E.mail: ho2099@sib.co.in*





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