



How to
BUILD SELF-HELP GROUPS
for successful
BANKING WITH THE POOR

A Rural Model



Cover photo: A women's self-help group in Pattigadda, Southern India.

P R E F A C E

The Foundation for Development Cooperation is an independent private sector research organisation based in Australia and concerned with issues of development policy. Given the continuing challenge of large-scale global poverty, its first major project, **Banking with the Poor**, aimed to explore the scope for increased access to credit for the very poor in developing countries on a sustainable commercial basis. Drawing on practical experience in eight Asian countries, the findings demonstrated that partnerships between commercial banks, non-governmental organisations and self-help groups can provide a sustainable flow of credit to the poor, thus helping them to help themselves.¹

The purpose of this particular booklet is twofold. Firstly, it is to draw attention to the key role of self-help groups (SHGs) and non-governmental organisations (NGOs) in providing better access to credit for the poor in rural areas in developing countries. Secondly, it is to provide NGOs and self-help groups with *practical guidelines and estimated costings* for the formation, training and operation of self-help credit management groups.

The information given is based generally upon the detailed country studies carried out within the **Banking with the Poor** project. More particularly, it draws from the practical experience of MYRADA (Mysore Resettlement and Development Agency), a non-governmental organisation which has already formed over 2000 self-help groups in Southern India.

¹ More information on the findings of that project, and the recommendations which were communicated to banks, non-governmental organisations and a range of governments and international agencies can be found in the report *Banking with the Poor* (1992) and its successor report *Best Practice of Banking with the Poor* (1995).

The Foundation has also published two reports on transaction costs in the context of banking with the poor: *Transaction Costs of Lending to the Rural Poor: Non-governmental organisations and self-help groups of the poor as intermediaries for banks in India* (1995), and *Transaction Costs of Lending to the Poor: A case study of two Philippine non-governmental organisations* (1996).

With advice and support from NABARD (National Bank for Agriculture and Rural Development), it has already helped many of these groups to form linkages with commercial banks such as the Vysya Bank, Bangalore. Material prepared by representatives of MYRADA, NABARD and Vysya Bank has been integral to this booklet.

Based as they are upon some of the most successful experiences in this field in Asia today, the information and guidelines in this booklet can be applied or adapted by self-help groups or NGOs elsewhere to meet some of the most pressing needs for credit of the poor in their own countries.

Though this booklet refers primarily to the formation and operation of self-help groups in a rural context, a companion booklet oriented towards an urban context is also available from the Foundation.

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I The need of the poor for better access to credit

Poor people in developing countries survive through self-employment in trade, services, crafts and petty manufactures as well as in agriculture. But lack of access to credit is a crucial barrier to their capacity to help themselves. A significant proportion of the world's poor still remains outside the ambit of formal credit institutions and thus still depends on private sources and moneylenders to meet their credit needs.

Experience in the **Banking with the Poor** project and elsewhere shows that, given the opportunity to gain access to formal credit, such people are able and willing to come out of the poverty trap to find a decent living. Experience also suggests that small groups of poor people with similar interests and goals are able to work together effectively to augment meagre resources. To such well-organised self-help groups, assistance can be given to secure greater financial, technical and moral strength.

In many developing countries, non-governmental organisations (NGOs) have formed self-help credit groups in rural villages, on the basis that whenever a homogeneous group of poor people shares an environment and common needs they are bound to take up activities jointly which are meant for the welfare of the whole group. For example, MYRADA (Mysore Resettlement and Development Agency) in Southern India is implementing many village development programs, and has already organised some thousands of credit management groups based on the principle of self-help.

It is increasingly being recognised that poor people, particularly those already organised into self-help credit management groups, are bankable. Such groups are already engaged in informal banking operations through the activities of credit and thrift. It is therefore feasible for banks to be involved with provision of finance to self-help groups, and also to be involved with extending complete credit packages, especially for productive purposes. Though small, consumption and productive needs of the poor need to be met when they arise, if the poor are not to be forced into the hands of non-formal credit agencies and moneylenders — hence the need for linkage of self-help groups with banks.

2 Banking with the Poor

This unique regional project was aimed at exploring, demonstrating and publicising the potential for increased access to credit for the poor on a sound commercial basis, especially in developing countries in Asia. Through the commitment of leading commercial bankers and prominent non-government organisations in eight Asian countries² made at an initial regional workshop in Manila in May 1991, detailed case studies were carried out in each participating country in 1991 and 1992 to explore the effectiveness of linkages between non-government organisations and banks in providing commercial credit to the poor.

Major findings of Banking with the Poor were:

- **The poor make good credit risks; they have a high savings propensity, and are fully bankable.**
- **Their main problem is to achieve better access to credit, rather than to reduce its cost.**
- **With increased access to credit, they are willing and able to help themselves.**
- **Women borrowers and women's self-help groups have proven to be the most reliable and successful in this field.**
- **Commercially sound linkages have been established between the formal finance sector (including commercial banks) and well managed non-governmental programs and self-help groups among the poor.**

² Bangladesh, India, Indonesia, Malaysia, Nepal, Pakistan, the Philippines and Sri Lanka.

3 The basic role of self-help groups (SHGs)

The most common thread that runs through all of the country case studies is their basic reliance upon self-help groups for savings mobilisation and credit delivery. Indeed, detailed research carried out in those studies and elsewhere strongly supports the finding that *self-help groups are, or readily can become, the fundamental building blocks for a successful program of credit for the poor.*

Characteristics of self-help credit management groups

A self-help credit group is a voluntary association of persons with common interests, formed democratically, and without political affiliations. The main objective of the group is to improve the economic and social status of the members in terms of their felt needs and interests. While the group's activities are multi-purpose — for example, community welfare and village development activities — they often have a special focus on thrift and credit management. Although unregistered, the group functions within the framework of an informal set of by-laws framed by the members themselves. These groups distinctly differ from cooperatives where heterogeneity is a common and sometimes divisive factor. The number of members in such groups usually ranges from 10 to 25.³

The savings and lending procedures adopted by the groups are very simple and are based on the mutual trust and confidence of the members. As a democratic body, all the members have equal opportunity to speak and express their opinions, and decisions are made unanimously after discussion among themselves. The purpose of loans provided is need-based, and prioritisation among different purposes and members is collectively decided.

The interest rate charged (or 'service charges') varies widely both among different groups and for different purposes in the same group. However,

³ MYRADA and other NGOs now limit groups to a maximum of 20 members, due to more stringent legal requirements applying to the operation of groups in excess of that number in India.

while the interest rate charged may often be higher than in the formal credit system, the borrowers are willing to pay the higher interest since this is still far less than that charged by local moneylenders. At the same time, the assistance is provided in a timely manner and the benefit derived from the higher interest goes to the group itself. The terms and lending norms — that is, unit cost, repayment, interest rates etc. — are quite different from the lending procedure followed by formal credit institutions. However, loan repayment performance is generally exceptionally good.

Fundamental to the success of self-help groups in savings mobilisation and sound credit management is the strong sense of self-reliance of the group. The common fund, first established from group savings, is their fund. As opposed to official welfare ‘hand-outs’, *they own it and therefore control it*. This sense of ownership and control and the human dignity achieved by such self-reliance are the keys to the success of the self-help movement and of building financial discipline for **Banking with the Poor**.

Banking with the Poor experience

The **Banking with the Poor** case studies have clearly demonstrated the considerable qualities of self-reliance and inherent strength of the poor, especially when they are able to organise themselves into cohesive self-help groups. Such groups, once organised and properly trained, have demonstrated their ability in the following areas:

- to mobilise savings and to manage credit in a financially sound and disciplined manner
- to provide group pressure and guarantees as an effective substitute for collateral
- to reduce transaction costs significantly on small loans through voluntary and other contributions of the group
- to ensure payment of market rates of interest
- to achieve high loan repayment rates
- to demonstrate through the above achievements their financial viability and their readiness to serve as financial intermediaries in a fully commercial context.

4 The key role of non-governmental organisations (NGOs)

The **Banking with the Poor** case studies confirmed that NGOs have a key role to play in securing improved access to credit for the poor. This consists of:

- 1) training existing self-help groups and assisting in the establishment and training of self-help groups within the poorer sections of society, especially towards thrift and credit management goals
- 2) providing better access to credit for such groups by promoting a linkage between such groups and formal banking institutions.

The Foundation for Development Cooperation has recognised and endeavoured to explore these important functions of NGOs in all its case studies. And although important variations have been observed in some of the case studies, these have been more in the nature of variants in methodology than in the basic philosophy and principles involved.

5 Typical phases in the formation of self-help credit management groups

The role of NGOs in forming and training self-help credit groups typically involves the following phases.

Phase I

Initial contact and the beginnings of the group

NGO staff members entering a poor village area may find that a self-help group already exists, is cohesive, and simply needs encouragement and advice to transform it into an effective self-help savings and credit management group. In other cases, the NGO representative may meet with an apparently inchoate assembly of poor villagers *to listen to* and discuss their needs and problems. After endeavouring to provide appropriate advice or assistance to address these problems, the NGO frequently identifies a

desire among the people to establish a self-help group to deal with their ongoing needs for credit and savings.

In either (or both) of the above cases, the NGO may offer further advice and assistance in the formation of a group of 5–25 members to mobilise savings and manage credit for their most urgent needs, and in the election of officers. This input from the NGO will be based on general grassroots experience, and upon principles intrinsic to the formation and operation of self-help groups, for example, that groups be homogeneous. (See Section 6 for a more detailed list of guiding principles.)

The formation of a self-help group is usually facilitated by an NGO identifying a specific village area and potential members, based on their similar attributes and needs. Building the group dynamics and promoting the concept of working together through cooperation and collaboration is a very important task of the NGO in this phase. Success in the formation of self-help groups depends heavily upon the sensitivity and skill of the NGO staff member who acts as a change agent. Likewise, acceptance of a change agent by the client group is of prime importance.

Establishing group cohesiveness and basic financial management skills

Once the group is formed, the NGO extension officer needs to spend time in training the group and its leaders in the techniques of savings mobilisation, and how savings may be used for emergency or urgent consumption needs. Training must also be given in elementary bookkeeping and financial management for the group.

Such group savings will often be deposited in a common fund, to be managed by the group to help meet their most urgent consumption or emergency needs. This will usually be inadequate to meet the larger credit requirements for productive purposes. However, the discipline of the group in mobilising its own savings and in managing its own common fund provides an ideal preparation for dealing with the formal financial sector, whose capital resources will be needed to fund the more substantial requirements of credit for productive loans. (This has already been achieved

in some of the Foundation's pilot linkage programs with commercial banks mentioned below.)

NGO staff after forming the group help to identify a group leader and offer to him/her extensive training in conducting the group meetings, maintenance of records, etc. The thrift habit should be inculcated from the beginning to meet their immediate need for emergency or consumption purposes. Small loans for such purposes are given to individual beneficiaries out of the total savings of the group, based upon group consensus. This entire process of formation of the group and its stabilisation normally requires a period of six months.

Phase 2

This phase relates to the necessary training of group members for appropriate productive activities.

During the process of formation of the group, NGO staff will look into the existing skills, attitudes, and knowledge of individual members in various fields. In this phase, the identified skills should be properly developed by appropriate training provided through the NGO. The period of this phase may be six months, which includes special training programs in different vocational areas.

Phase 3

To encourage the group members to take up loans for more productive activities, provision of seed money assistance to an appropriate level (depending on group effectiveness and matching savings) may be made. (The seed money assistance can also be considered during Phase 2 itself.) Its provision helps prepare the group for linkage with banks to secure more adequate capital for productive purposes. Such linkage with banks, either directly or through NGO intermediation, might be expected to take place 11 or 12 months after the formation of the self-help group.

Estimated costings for the formation, training and operation of self-help credit management groups have been provided in an appendix.

6 Guiding principles for the operation of self-help credit management groups

- 1) SHG membership should be resident in the same area, be homogeneous, and number at least five persons.
- 2) SHGs should promote savings mobilisation.
- 3) Savings should be linked to credit: savings first, credit next.
- 4) The development of financial disciplines and systems should be encouraged.
- 5) SHGs should begin with a simple bookkeeping system.
- 6) SHGs should hold regular meetings (once a week if possible).
- 7) They should have basic rules or by-laws (written or unwritten).
- 8) Group leaders should be elected by the members, with group functions or positions being rotated among the members.
- 9) Transparency in business operations and the overall conduct of group activities should be maintained at all times.
- 10) Basic training and guidance should be provided to members of SHGs.
- 11) The autonomy of SHGs should be respected.
- 12) Group liability and peer pressure should be the substitutes for collateral.
- 13) Loans should be kept small initially and repayments made frequently and regularly.
- 14) Transaction costs should be kept to a minimum through simplified group procedures and control.
- 15) Market rates of interest should apply to both savings and credit, to achieve financial viability as soon as possible.
- 16) Commercial banks should be asked to provide appropriate advances or lines of credit to supplement the group's financial resources and to enable it to lend for productive purposes.

These guiding principles have emerged on the basis of eight case studies carried out for the Foundation in 1991 and 1992, and of detailed research undertaken by other organisations (especially by APRACA and GTZ in Indonesia) over several years.

7 Linking banks with self-help credit management groups

Due to the very nature of NGOs and their objectives, NGOs can be considered as appropriate implementing agencies in the development of self-help credit management groups, and in facilitating their linkage to banks. As pointed out above, self-help groups are often able to mobilise sufficient savings to establish a common fund to meet their most urgent consumption or emergency needs, but these are usually inadequate to fulfil the larger credit needs for *productive* activities of members of the group. However, after demonstrating financial discipline in mobilising and managing its common fund, the self-help group is in a position to approach the formal financial sector, especially the commercial banks, to fund the requirements of more substantial credit for productive loans.

At this stage, NGOs may be able to play a key role in introducing financially responsible self-help groups to banks, and in helping them to negotiate reasonable lines of credit. They may also assist in devising practical arrangements for self-help groups to act as financially viable and responsible intermediaries to the poor.

8 Tangible results

Such outcomes are not a pipe dream. In less than 12 months from the start of the Foundation's **Banking with the Poor** project, leading Asian banks contributed over US\$2 million to NGOs and self-help groups engaged in **Banking with the Poor**. In one case, following the action of an NGO in forming and training several self-help groups in southern India at an average cost of US\$530 per group, a major commercial bank committed a line of credit to each group of Rs 200,000 (or close to US\$7050)

per group for productive purposes. This is a multiplier of over one thousand per cent! This precedent has already been repeated in hundreds of other cases.

9 A call to action

The practical methods and significant results described above call for serious consideration and action by all concerned including governments, banks, NGOs and international organisations which have pledged themselves to the alleviation of poverty as a primary objective in the present decade. This paper (and the comprehensive report on **Banking with the Poor** upon which it is based) provides some straightforward, practical guidance.

It can be done by:

- 1) the poor forming themselves into viable self-help credit management groups
- 2) NGOs in developing countries intensifying their efforts to help the poor to do so, using some of the successful guidelines and principles outlined in this booklet
- 3) banks in developing countries providing the necessary financial assistance or lines of credit to self-help groups on a sound commercial basis
- 4) governments and central banks in developing countries providing the necessary policy, regulatory, technical and financial support to NGOs, self-help groups and banks for this purpose
- 5) international organisations, financial institutions and bilateral aid agencies providing the additional technical, financial and policy support needed by NGOs and self-help groups to implement some of the low-cost/high-benefit methods described here
- 6) other organisations and individuals in the First World, who wish to support such NGO and self-help group efforts in the Third World, providing the small amounts of seed funding to help NGOs establish such groups (only about US\$530 per group).

10 Conclusion

It is hoped that this paper will be of some practical assistance to all those who share the Foundation's conviction that the poor are able and willing to help themselves, if only given the smallest opportunity and support to do so.⁴

⁴ More detailed information on the broader experience of banks and NGOs in **Banking with the Poor** can be found in the complete report entitled *Banking with the Poor*, and in the other publications of The Foundation for Development Cooperation noted in the preface.

Estimating the cost of forming self-help credit management groups

These estimated costings for the formation of self-help credit management groups have been prepared on the basis of the experience of MYRADA, an NGO in southern India. The basic characteristics of the groups which have been assumed are as follows.

- 1) The group should have 10–25 members of homogeneous interests, in terms of socio-economic status, specific economic activity, problems and needs.
- 2) The NGO should take up the responsibility for the formation of the group and it is assumed that the entire process will take up to one year.
- 3) During Phase 1 and Phase 2 of the formation (see earlier description in Section 5), the group will develop the thrift habit out of their existing earnings, and meet their consumption needs out of the group savings thus generated; loans will be provided to individual members on a repayable basis with interest charged for such facilities.
- 4) The savings mobilised by the group members will be adequate only to meet their consumption needs. But, in due course the need will emerge for productive as well as consumption needs. Seed money assistance is therefore necessary, and can be provided from the seventh month onwards (depending on the progress of the group, the seed money may be considered at any time from the third to the ninth month of the group's formation). The seed money assistance may roughly match the group's savings.
- 5) The NGO should help the group identify a leader to undertake and coordinate the activities of the group; the NGO should provide necessary training for him/her to do the banking operation as well as bookkeeping for the group.
- 6) The NGO should arrange activity-oriented training programs for the group members to develop skills for augmenting their income through productive activities.

On this basis, the total estimated cost for formation of self-help credit management groups works out to about Rs 15,000 (US\$530) per group as detailed below.

**Cost of self-help credit management group formation
(per group, per year)**

	Rs	Rs	US\$
Group leader expenditure			
Monthly allowances (Rs 150 per month)	1800		
Monthly meetings (Rs 25 per meeting)	<u>300</u>	2100	75
MYRADA field staff expenditure			
Salary for one field staff per group per year	*2400		
Transport expenditure	<u>400</u>	2800	100
Training expenditure			
Orientation training to group members (initial period one time)	300		
Activity oriented training program (six-monthly program @ Rs 750 per program)	<u>4500</u>	4800	170
Seed money assistance			
Estimated production credit requirement as seed money (Rs 200 per member x 25)	**5000	5000	175
Other expenses			
Purchase of records and note books	300	300	10
TOTAL		15,000	530

* NGO field staff can develop 12 groups per year and the monthly salary for field staff is Rs 200 (US\$7) per group per month. Hence, the staff salary per group per year works out to be Rs 2400 (US\$85).

** The estimated productive credit requirement since seed money assistance is assessed according to the savings rate of the group members as well as the requirement for some initial productive credit. The case study experience of self-help groups organised by MYRADA suggests that the seed money requirement per member could be Rs 200 per year and hence the total seed money assistance per group (of 25 members) works out at Rs 5000 (US\$175).

THE FOUNDATION FOR DEVELOPMENT COOPERATION

The Foundation for Development Cooperation (FDC) is an independent, non-profit and non-partisan organisation whose aim is to strengthen international cooperation and development. It does this by undertaking, promoting and supporting activities to improve the quality and increase the quantity of aid to developing countries, and to promote development cooperation with these countries. It is the only such organisation in Australia. The late Bill Taylor, AO founded FDC in 1990 and served as Vice-Chairman until 1995.

The mandate of FDC calls for it to conduct policy-oriented research, foster public awareness, mobilise broader Australian and overseas interest and participation, and support non-governmental efforts to promote development, especially at the grassroots level. This mandate has been endorsed by legislation of the Australian Parliament, amending the *Income Tax Assessment Act*, to allow tax-deductible status for the Foundation.

The Foundation has developed close working relationships with Australian and international organisations (official, private and voluntary) and with its overseas counterparts (the Overseas Development Institute in the UK, the Overseas Development Council in the United States and the North-South Institute in Canada).

FDC's core budget is derived entirely from private sources. Support is now being received from other private foundations, corporations and individuals which will ensure the Foundation's viability as an independent policy research organisation contributing to international development and cooperation. Among these is a recent substantial grant from the Ford Foundation. Funding for specific project-related activities has also been

received from government and international sources — the Australian Agency for International Development (AusAID), the World Bank, the Asian Development Bank and the United Nations Development Programme).

The policies and programs of FDC are determined by a Board of Governors comprising Dr Brian Scott (Chair), General Eva Burrows, Sir Llew Edwards, Sir Laurence Muir, Mr Stephen Taylor, Professor Roy Webb and the Hon. John Wheeldon. The late Sir Gordon Jackson, who chaired the committee whose 1984 report (the Jackson Report) revitalised Australia's official development cooperation program, was a founding governor. The Executive Director is Dr John Conroy. He is responsible for the implementation of policies and programs agreed by the board, with the advice and assistance of a Program Advisory Panel.

The Foundation's major activity to date has been a project, **Banking with the Poor**, which has demonstrated the scope for increased access to credit for the poor in developing countries on a sound commercial basis. It has shown that the creative and productive capacities of the poor can be realised by their increased access to credit. The uniqueness of this project lies in the establishment of linkages between commercial banks, indigenous non-government organisations (NGOs) and self-help groups of the poor to provide a sustainable flow of credit, thus helping the poor to help themselves.

Apart from projects of an applied and action-research nature, such as **Banking with the Poor**, the Foundation is an innovator in its studies of international and regional development issues, and in particular the aid, trade and investment relationships of Australia with its neighbours in the Asia-Pacific region.