Primary Agricultural Society Linkage – the best remote self-help groups in India can do?

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Models linking community-based associations with financial institutions have tremendous potential to expand outreach in remote areas. Associations in many forms (self-help groups, savings and credit associations) already have a strong presence in rural areas. They generally provide convenient access for members who have few or no alternatives. Linkages can provide these associations with access to liquidity exchange, safety for savings and the potential for a broader range of services, even graduation to individual services.

The self-help group bank-linkage model in India is known to be one of the fastest-growing microfinance programmes in the world. Self-help groups are informal thrift and credit groups of the poor that came to be recognized as bank clients under the pilot project. Starting with 500 SHGs the cumulative number of linked SHGs stands at 2.2 million today, reaching about 31 million families and linking to financial institutions including commercial banks, regional rural banks and cooperatives.

This case study highlights key opportunities and challenges in linking community-based associations with member-owned institutions such as cooperatives for remote outreach. The case answers the following key questions: is this an effective model for remote outreach? Is there added value because these associations are member-owned?

THIS ARTICLE FOCUSES ON LINKAGES between two distinct kinds of member-owned institutions (MOIs) in India: first, largely informal associations called self-help groups (SHGs), and second, highly institutionalized government-promoted credit cooperatives called primary agriculture credit societies (PACSs). PACSs are part of a three-tier formal cooperative system (PACSs at the village level, district central cooperative banks, DCCBs, at the district level, and state cooperative banks at the state level).

Credit cooperatives have existed in India for more than a century

Cooperatives are autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise. Credit cooperatives have a history of more than a century in India and the role of the state as promoter was part and parcel of the movement from the very

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beginning. A key finding of India's first Famine Commission was the importance of cooperative finance and it recommended that a system based on a model developed by Friedrich Raiffeisen, a German provincial politician and social reformer, be established throughout British India to take cheap credit to India's farmers. The first Cooperative Law of India was enacted by the British in 1904. The law referred only to credit cooperatives and was repealed by a new law to cover all kinds of cooperatives in 1912. Later administrative reforms in 1919 gave powers to provinces/states to enact their own cooperative laws. These initiatives enabled formation of as many as 100,000 cooperatives within the first 25 years of the history of cooperatives in the subcontinent.

The current form of the PACS is the result of almost a century of policy and regulatory shifts oriented primarily towards ensuring the flow of cheap credit for rural and especially agricultural development.

Until 1990, in part driven by the poor performance of the cooperatives, the focus was on controlling the vast network's governance and management risks by increasing government control. More recently in recognition of the spread and depth of outreach of PACSs, far-reaching changes are proposed for this system, including divestment of state shares (reflected in parallel laws already in place in 9 of the 25 states in India), special audits, improved management information systems, streamlining of the three-tier system, and conditional capitalization. This aims to make the PACS a viable rural financial institution.

Why link with PACSs for remote outreach?

India has one of the most inclusive financial sectors in the world

India has one of the most inclusive financial sectors in the world with a rural financial network including over 32,000 rural branches of commercial banks and regional rural banks (RRBs), 14,000 cooperative bank branches, 112,609 PACSs, approximately 1000 microfinance institutions (MFIs), a large post office network with 154,000 branches largely focused on deposit mobilization, and finally 2.2 million SHGs.

Policies required banks to expand coverage to underserved areas

Policy and financial liberalization have contributed to this outreach. ‘Between bank nationalization in 1969 and the onset of financial liberalization in 1990, bank branches were opened in over 30,000 rural locations which had no prior presence of commercial banks’ (Burgess and Pande, 2004). Policies introduced in the 1990s specifically required financial institutions to expand coverage to underserved areas, for example the 1:4 licence rule (now ended) demanded that for every branch opened in a banked location the bank would have to open four branches in previously unbanked locations. Such initiatives had a significant effect on expanding branch coverage in rural, especially remote unbanked, areas. Further, all scheduled commercial banks are required to offer 40 per cent of net bank credit to designated priority sectors, and general insurance agencies in India are required to source 5 per cent of their gross premium within three years of operations from rural areas (2 per cent in the first year).

Despite these initiatives and the over 50-year history of reforms in the financial sector, the All India Debt and Investment Survey of 1991 showed that formal institutional sources provided credit support to only around 64 per cent of rural households. Informal sources extended credit to about one-sixth of the rural households. The SHG–bank linkage programme introduced in 1992 has been seen as a key to addressing this anomaly.

PACS–SHG linkages hold promise to extend this outreach by allowing one of the most rural financial institutions to reach even further. There is some optimism about the relative strength of commercial banks in lending for agriculture, since they outperform cooperatives in terms of market share (commercial banks 57 per cent and cooperative banks 34 per cent according to 2002-03 data, GoI, 2005). Commercial banks are the primary competitors of cooperatives for establishing linkages with SHGs (see also Harper et al., 2004). However, PACSs have a much wider reach than commercial banks in rural areas. A total of 112,609 PACSs means there is one credit cooperative for every six of India's villages with approximately 135 million members. Commercial banks have only a quarter of these outlets. PACSs also have a much deeper reach with nearly four times the number of accounts of commercial (public sector) banks, and an average loan size of only Rs6637 ($154) compared to Rs31,585 ($735) of commercial banks. 'In a country predominated by small or marginal land holdings, the reach of the cooperative system is much deeper than the other institutional arrangements in the rural areas' (GoI, 2005). Depth is also indicated by the nature of PACS membership, with almost 30 per cent of the membership base of the societies and 20 per cent of the borrowers being from India's most disadvantaged social classes.

As shown in Table 1, the coverage of rural areas and depth of outreach of cooperative banks outperforms even RRBs, introduced in 1975 by a special act to extend access to financial services in rural areas.

The institution that has really enabled greater depth and breadth of rural outreach, as well as expanding the role of the rural financial institutional network, is the self-help group. SHGs are the most decentralized financial service option for rural communities. A linkage between PACSs and SHGs takes an already rural member-owned institution and further broadens and deepens access. This linkage also expands the coverage for women, particularly of lower social castes.

A linkage between PACSs and SHGs further broadens and deepens access

Nevertheless, issues still persist. Only an estimated half of SHG members are poor (EDA and APMAS, 2006) so populations are still left out.

Table 1. Comparative coverage of rural markets by regional rural banks and cooperatives

	RRBs	*Cooperative banks (mainly via PACSs)*
Number	196	397
% rural branches	83%	n.a.
Total deposit balances ($ billion)	10	21
Total credit outstanding ($ billion)	4.27	19.13
Credit in rural areas, % of total credit	72%	100%
Credit in 'small' rural accounts (loans less than US$4,200), % of total outstanding credit	65%	>90%*

Notes: All figures are for March 2002, except for information related to cooperative banks and the share of rural bank business (last two rows) where March 2001 data is presented; * authors' estimate.

Sources: RBI (2001; 2002a) as quoted in Sinha et al., 2003)

There are also problems in relation to the geographical spread of SHGs – for example 44 per cent of linked SHGs are concentrated in the south of India. Nevertheless, they do offer potential for both breadth and depth of outreach and when combined with the grid of institutions like PACSs – they have the potential to reach virtually every village in India.

Linkages between cooperative banks and SHGs (mainly via the PACSs) started relatively late in India. While the bank linkage programme, supported by the National Bank for Agriculture and Rural Development (NABARD), was initiated in 1992 its early focus was mostly on scheduled commercial banks (Harper et al., 2004). However the potential that the SHG–cooperative society linkage offered was recognized by NABARD, which has been actively supporting DCCBs and PACSs in their linkages with SHGs. The number of SHGs linked to cooperatives as a percentage of overall linkages has been steadily increasing. In 2001 the figure was only 4.84 per cent (Berkhof, 2003), but it has now increased to 13 per cent (www.nabard.org).

The number of SHGs linked to cooperatives as a percentage of overall linkages has been steadily increasing

In terms of numbers of SHGs linked in this year compared to cumulative performance, the cooperatives seem to be outperforming both RRBs and commercial banks. The ties with SHGs have meant, however, that the portfolio of cooperatives is not growing at a significantly higher rate but has kept on a par with other agencies, as shown in Table 2.

Two questions arise from an analysis of linkage types. First, is there an area where there has been a higher rate of linkages between PACSs and SHGs and why has this happened? Second, why are more SHGs not link-

Table 2. SHG linkage status of different rural financial institutions

	DCCBs	*RRBs*	*Commercial banks (public sector and private sector)*
Cumulative no. of SHGs provided with bank loans (March 2006)	307,543	740,024	1,188,040
Cumulative bank loan disbursed up to March 2006	$251 million	$772 million	$1,624 million
No. of SHGs provided with bank loan between April 2005 and March 2006	96,406	176,178	344,567
As % of cumulative performance	31%	23%	29%
Bank loan disbursed between April 2005 and March 2006	$102 million$	284 million	$657 million
As % of cumulative performance	40%	36%	40%

Source: www.nabard.org, accessed 1 November 2006.

What do SHGs gain from linkage to PACSs?

ing to cooperatives given their relative proximity? This case explores the latter question in an attempt to understand the exception better.

A final question centres on the best of the remote linkages and ask what are the challenges and opportunities? Ultimately what do SHGs gain from linkage to PACSs, and what is the security of their savings with these institutions (Harper et al., 2004)? It is not necessarily the case that SHGs are an ideal 'fit' for cooperative banks in their present condition, SHG linkage with them should only be promoted if it will assist them to improve their position.

The case of West Bengal

The health of the cooperative sector in West Bengal is fairly good

West Bengal has made early and significant progress in SHG–PACS linkage, and is notable for being one of the very few states outside south India to do so. Approximately 45 per cent of the SHGs in the state are linked to cooperatives (well above the national average) and in general the health of the cooperative sector in the state is fairly good, with West Bengal being one of five top performers in terms of percentage of PACSs in profit in 2002 (GoI, 2005).

Certain other features make for an enabling environment for SHG–bank linkage in West Bengal. The state cooperative law allows for groups to be members of cooperatives thereby providing an opportunity for SHGs to be registered entities. Additionally, and to ensure member ownership, the act provides for one member one vote, as against one share one vote elsewhere in the country, in order to avoid the risk of large (rich) shareholders dominating the cooperatives.

Volunteers from the Communist Party of India help with promotion of groups and bookkeeping

However West Bengal's SHGs also face unique 'risks', one of these being the influence of the Communist Party of India (Marxist). Volunteers from the party not only help with promotion of groups and bookkeeping, but also in tracking progress of the movement through informal reporting processes. This however does make the groups dependent on a political party which can use them as a mass base during elections, especially as the movement scales up. In less remote groups we found even our own interactions with the groups were attended by CPI(M) volunteers, though in some cases, such as the PACSs currently under review, the influence of the PCI(M) was less, either because of the extreme remoteness of the area, or the relatively small numbers of SHGs promoted there. However, as the movement scales up it could form a significant political base for the party.

Since the focus of the study was on remote outreach, in particular those areas with a high proportion of poor households, Purulia district was selected for the study of PACS–SHG linkage, despite the fact that in the state in general it is an average performer in terms of scaling up of SHGs. Purulia is the poorest district in West Bengal (lowest per capita income) and in fact one of the poorest in India with 43 per cent of families living below the poverty line (GoI, 2004). It is a remote district, on a landlocked border of West Bengal and was transferred as an afterthought from the neighbouring state of Bihar. There are 130 PACSs in the district. Households here are largely dependent on agriculture and follow monocropping (mostly paddy cultivation).

Bararanga PACS is the last PACS in the block, located 7 km away from a permanent road and 30 km away from the agricultural market. Out of the local population, 80 per cent is tribal and scheduled castes. In addition to paddy (cultivated between April and August) some households (especially women) in Bararanga block have begun to cultivate sabai grass (used to make rope and baskets) and vegetables to supplement the family income. For those without any land the options are agricultural labour and stone crushing. Seasonal migration is a common livelihood strategy, especially amongst tribal households.

Breadth and depth of outreach

The Bararanga PACS is located in a gram panchayat (an administrative subunit, in this case consisting of 17 small villages) bordering the Purulia and Bankura districts, which has a population of approximately 1,400 households. Of these households, 98 per cent are members of the PACS due to the state government's policy of universal membership. More than 55 per cent of the population are savers with the PACS and 27 per cent are borrowers. Since not everyone needs credit, the current level of borrowers seems standard. But there are issues relating to the direct agricultural lending of the PACS. Problems, according to male members of a SHG in the village of Sonkura, include collateral requirements, time-consuming paperwork, and the non-availablity of loans at the time when they are really required. In addition, PACS members mentioned liquidity problems, an issue that seems to be related to problems of accessing funds on time from the DCCB (currently PACSs are not allowed to borrow from other sources) and being able to plan to meet liquidity peaks and troughs.

Eighty-five SHGs are linked to the Bararanga PACS, with over 16,000 members most of whom are female. SHG linkage in the sample universe (studied at the level of the third tier i.e. the DCCB) has been growing at a steady rate for the last three years (see Table 3). However, the cost to the PACSs of mobilizing SHGs and providing services in remote areas is quite high. Therefore, in these areas there is less growth. This is reflected in the general experience of SHG-bank linkage at a national level, where the policy has only reached around 50 per cent of the poor and a very limited number of very poor clients (EDA and APMAS, 2006).

The cost to the PACSs of mobilizing SHGs and providing services in remote areas is quite high

Two factors inhibit growth in remote areas: consolidation at the PACS level and liquidity shortages. Discussions with staff of the Purulia Central Cooperative Bank (PCCB) revealed that promotion of SHGs in remote and underdeveloped areas is challenged by the low density of population, extreme poverty and high migration rates. Also, after the first year of seeing a high growth rate and experiencing no significant improvements in repayment rates, PCCB actively encouraged consolidation rather than high growth in numbers of SHGs. This strategy has helped in lowering default rates, which were higher in the year of peak SHG growth when the repayment rate was 60 per cent, but have now improved to an 82 per cent repayment rate (see Table 3).

Regarding the poverty of the sample, wealth ranking exercises with randomly selected groups in two of the 17 villages in the PACS's area indicated a 20–50 per cent presence of extremely poor clients in 70 per cent of the groups. The remaining groups were either entirely made up of extremely poor households or entirely middle class.

Sustainability of SHGs and PACSs

The PACS itself is operationally sustainable and the SHG ‘product line’ is well-performing and financially feasible. The PACS is operationally sustainable at 99 per cent, although it is yet to wipe out its accumulated losses. For the first time in 30 years (since its registration in 1976) the PACS is in profit.

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Table 3. Purulia District Central Cooperative Bank: Status of SHG linkage

	As on 31 March 2004	*As on 31 March 2005*	*As on 31 March 2006*
No. of SHGs savings linked	618	1,076	1,326
Total no. of members	7,044	1,3221	1,6067
Savings mobilized (in $ thousands)	32.6	66.5	89.3
No. of SHGs credit linked	235	287	341
Total no. of borrowers	3,305	3,504	4,310
Loan disbursed (in $ thousands)	82.6	141	173
% of recovery	60%	60%	82%

A key reason for relatively low operating costs (6 per cent) is low personnel costs. Annual salaries (such as $222 for the senior manager /secretary) do not attract the best local talent – which in remote areas is limited in any case. To some extent, cost control at the expense of quality services and appropriate risk management is what is keeping the PACS afloat.

Compared to the overall performance of the PACS, the SHG portfolio is particularly well performing. A repayment rate of 82 per cent compares favourably with the overall 57 per cent repayment rate for the PACS. Predictably, operational self sufficiency is 97 per cent, despite the low number and low growth rates in the SHG programme – largely because costs required to promote and maintain quality SHGs have not yet been invested in the programme. The operational expense ratio is a low 1 per cent. The medium-term impact of cost cutting is likely to be on quality of the groups.

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Despite some reasons for optimism, for this to be a truly sustainable model, the current orientation of the PACS would need to change because the organization is currently viewed primarily as a credit dispersal agency rather than as a savings-based institution (see the Conclusion for further discussion on this).

The lack of focus on savings and the regulatory prescription that determines that two-thirds of PACS resources be kept at the upper tier levels not only creates liquidity issues in the base tier but also pushes up the costs of capital. With an 11 per cent financial cost ratio, interest rates need to be much higher than the current levels, which range from 10 per cent (for agriculture loans) to 12 per cent (for SHG loans), in order to provide the necessary margins. However despite liberalization of interest rates for PACSs, fear of competition with local commercial banks tends to keep overall rates low.

Range of products and services

Rural households in the catchment area of the Bararanga PACS primarily go to three sources for access to financial services:

- moneylenders/landlords (typically, 10 per cent monthly interest rate, no fixed tenure, largely collaterized, used for life-cycle expenses, expenses for migration, and for working capital for agriculture);
- friends and relatives (typically, free, no fixed tenure, usually to be paid back in equal instalments, flexible in terms of use but largely taken for small consumption-related expenses or at the time of events such as marriages or deaths in the family);
- SHGs (typical contributions of Rs15-20 per month, 18 per cent interest rate to members, 12 per cent interest rate from PACS to SHG, no collateral, for PACSs savings account needs to be opened but savings are withdrawable).

By comparison, the commercial bank offers interest rates of 9.5 per cent, term loans for SHGs.

Worth of SHGs

Members of SHGs valued their ownership of the group

The greatest value derived by members of SHGs was as owners of their groups. When asked who owned their SHGs, all eleven SHGs with whom focus group discussions were held identified the members as owners. They declared that money borrowed from the SHG would still benefit the borrower as its interest would one day come back to them in the form of a dividend. When asked who they would borrow from if the local moneylender were to reduce rates of interest to a level comparable with the SHG, this sense of ownership became a deciding factor, prompting them to still prefer the SHG to the moneylender. Focus group discussions with members of SHGs also revealed the value of the SHG as a place to regularly keep savings, from where members could get small amounts of money as and when required, in a timely manner and with minimal paperwork.

The greatest value derived by SHGs (as opposed to their members) was as users of PACS' services, rather than as owners of the PACS – this ownership was not a deciding factor for choosing PACSs over other service providers. The PACSs were valued for low interest rate loans, for loans larger than those available from SHGs, for their proximity, for the local character of the institution with staff often being from the same village as the client, and for the fact that the PACSs stayed open until late evening and even provided a doorstep service, whereas commercial bank branches close relatively early. Realistically, however, PACSs are only marginally better financial services providers than SHGs. Larger loans are accessible, but the trade off is that liquidity is tied in forced savings.

Convenience and liquidity were highly valued

Convenience and liquidity, or ready access to savings and internal funds were the key deciding factors for financial service choices. In a less remote area where choice of service providers was greater, this reflected in the form of members actually withdrawing savings when a PACS asked them to keep all internal funds with the society. (This was in contravention of NABARD's guidelines, which do not require that internal funds be physically placed with the bank or cooperative in order to be considered when fixing the loan level). In this case the SHG promptly removed its savings from the PACS and transferred both its savings and loan account to a nearby commercial bank branch.

In remote areas the proximity and perceived accessibility of the PACSs made members choose them over other service providers such as commercial banks, which charge a lower interest rate than PACSs (9.5 per cent compared to 12 per cent) but have distant branches considered inaccessible. The commercial banks, according to remote SHGs, seem more relevant for the rich who could understand the more complex procedures and paperwork.

None of the 11 SHGs interviewed knew they had even nominal ownership of the PACSs, or that contributing share capital entitled them to any special benefits. For them the PACSs were service providers like any other, except closer in terms of distance and social acceptance. This is partly linked to the current legal status of SHGs within the PACS system as nominal rather than voting members. Although SHGs contribute 25 per cent of the deposit base of the PACSs they are not full members of the societies. Discussions with PACS staff revealed interesting issues in this regard: 100 per cent of the groups interviewed had savings with the PACS and 80 per cent paid share capital but none were voting members in the PACS. Access to loans in the case of full-voting members is tied to share capital contribution – the more the shares you purchase the more you can access. In the case of SHGs, it is linked to internal funds. Allowing SHGs full membership may actually limit their access to loans because they are unable to pay high amounts of share capital. Making the SHGs full members brought political risks because a highly informal agency such as the SHG could suddenly become open to political manipulation and attention upon their becoming stakeholders in a PACS. Given that the SHGs valued quality and timeliness of services over 'the need to own', the question of full membership seemed redundant. But at the same time a representation of SHG interest in the general body should have been considered. For example, in the case of the SHG that switched from a PACS to a commercial bank over the issue of internal funds, if the SHG had been able to contribute to decision making on this issue through some mechanism, their sense of control over their own savings and over the amount of loans leveraged would have been far greater.

Members were willing to build the group fund so as to obtain larger loans

This situation stands in sharp contrast to the sense of ownership within the SHG itself. Members were clear that they owned the SHG, had a right to its profits, and were willing to forgo short-term returns (in the form of dividends) to allow the group fund to build and so leverage higher amounts of loans in the future. They demonstrated an understanding of the trade-offs involved.

Despite weak supervision and internal controls there was trust in PACSs as safe keepers of SHG savings, largely because the staff of the PACSs were local and lived within the gram panchayat. However, this cannot be a substitute for regulation, supervision and strong controls.

SHG deposits in the PACSs are growing at a rate of around 100 per cent per annum. For the PACSs studied, this is a low cost contribution of 25 per cent to their deposit base. For SHGs it means that deposits are being placed with institutions that are yet to completely comply with a set of regulations, risk management systems and measures.

Regulation and supervision

Regulation and supervision of the linkages are inadequate

Regulation and supervision of SHG-PACS linkages suffer from multiple layers of inadequacy. The credit cooperative structure itself 'is said to suffer the problem of dual control' (Price Waterhouse Coopers, 2005). Cooperative societies are regulated under state laws for incorporation, regulation and winding up, and under banking laws for regulation of banking business. However, all cooperative societies engaged in the business of banking are not regulated by the Banking Regulation Act as the act does not apply to PACS, and related regulatory provisions are also not applicable to PACS, thus leaving them under the regulatory purview of the state. 'This in the past resulted in a number of restrictions on the managerial and governing autonomy of the cooperatives' (Zacharias, 2005).

The recent Vaidyanathan Committee has made a number of recommendations in this context (GoI, 2005):

- bringing cooperative banks on par with commercial banks in terms of prudent financial regulation;
- prescribing capital adequacy norms for cooperative banks (to be implemented in a phased manner);
- prohibiting any cooperative other than a cooperative bank from accepting public deposits from any person other than its members.

At present, the supervisor of the DCCB branch jointly with the cooperative inspector and the assistant registrar of cooperative societies inspects the PACSs, but on a sample basis. There is no systematic on-site and off-site supervision. Supervision is further weakened by the poor quality of audits and accounts. In accordance with directives of NABARD, the performance of cooperative societies is to be assessed and graded by the directorate of cooperative audit, with a clear rating system related to non-performing assets, observance of discipline, no-overdues, capital adequacy, earning capacity, efficiency of management and so on. Whereas A and B grading indicates a financially sound position and better financial management, C indicates average and D poor financial status. The directorate also appoints auditors chosen from a list of accredited agencies.

Compliance with the given system is a key problem. Although we repeatedly asked for a current and past record of the ranking – none was available. Therefore neither the DCCB management nor the PACSs themselves were in the habit of assessing performance or changes in performance over time. Accounting and bookkeeping were still weak for basic requirements, reflected in poor availability of audited reports, lack of consistency across reports and other failings.

The management of information systems is extremely weak in the PACSs and also in its relations with the SHGs. No internal reports, such as those relating to loan repayments, are available. Transactions were highly risky, always in cash, mostly managed by one staff member who is rarely transferred, and there are generally no random checks on amounts of cash, or any other checks and balances.

Finally a major purpose of any cooperative audit is so that members of the society can be satisfied that the affairs of the society are managed properly and on a sound business principles. In the case of the PACSs such a report is made on a regular basis at the annual general body meetings. However, the poor attendance of SHGs at such meetings (in some cases actively discouraged) means they do not have access to basic information about the custodians of their deposits. This is of particular importance because the PACSs are relatively insecure as it is optional for them to register under a deposit insurance scheme of the state. Many PACSs are also ineligible as they do not meet certain criteria. For example, in a study in West Bengal by Harper et al. (2004), 50 per cent of the 181 NABARD officers who answered the question on deposit insurance stated that deposits with the PACSs in their DCCB were uninsured, and a further 7 per cent said that the insurance scheme was inoperative. Only 43 per cent stated that deposits in the PACSs were insured. The sample PACS featured in this case study was one such example of a PACS with uninsured deposits.

The poor attendance of SHGs at AGMs means they do not have basic information about the custodians of their deposits

Cooperatives are not encouraged to actively increase their deposit taking

As SHGs are highly informal agencies they are not currently supervised by an external agency, the assumption being that they will be self-supervised. However, no specific model for self-supervision has emerged in the context of SHGs. The closest to any kind of monitoring or inspection of SHGs is 'rating' – basically a set of 10 to 15 parameters such as regularity of meetings, repayment rates and so on. However, rating is not done in an organized manner for PACSs linked to SHGs and nor is any report available to look at trends across SHGs.

The nature of regulation and supervision also severely limits the scope of products and services that can be provided by the PACSs. To date the PACSs cannot issue a demand draft, sell insurance policies, provide remittance services and more. In addition, due to weak compliance with prudential norms, cooperatives are not encouraged to actively increase their deposit taking. Even for cooperative banks, capital adequacy norms are low – the capital requirement only being Rs100,000 ($2,255). In this context, it is critical to either consider completely reorienting the currently credit focused approach of the PACSs or developing linkages that can enable them to extend services without jeopardizing client resources.

Conclusion

Is the SHG–PACS linkage viable and desirable as a means of remote outreach? It appears so on both sides. PACS benefit from a cheap deposit base and can explore a new market segment. SHG linkages with PACSs have the potential to broaden and deepen outreach in remote areas.

For the Bararanga PACS, assuming 15 members per group across a total of 85 groups, the linkage with SHGs has allowed the PACS to nearly double its outreach, and subsequently its savings and credit clients. SHG member savings in particular (already 25 per cent of the overall deposit base of the sample PACS) have enhanced the resource base of the PACSs and the value of SHG deposits for the system has not gone unnoticed, resulting in some fairly unique issues in the context of this linkage.

For remote SHGs where the nearest commercial bank branch may be 8-10 km away, the PACSs are the first source for large loans. Fairly mature SHGs (more than four years old) have already leveraged their internal funds by up to three times to raise PACS loans, although achieving this was slow, with initial loans being as little as eight-tenths of the internal funds of the SHG. Remote SHGs therefore get access to services that are otherwise expensive or unavailable.

At present, PACSs are simply not safe for accepting deposits

To optimize linkages a key in future is going to be whether to treat PACSs as deposit-based institutions or to treat them as credit dispensation agencies. There are arguments on both sides. The former means PACSs can lower financials costs, improve their liquidity status (with some changes in allocation of resources between PACSs and DCCBs) and provide a key service to members. However, the latter perspective emphasizes PACSs are simply not safe; SHGs and indeed any client will be placing their deposits with essentially weak institutions that generally do not have deposit insurance and have low levels of capital adequacy. In the interim, while supervision for PACSs and compliance with regulations (especially in remote areas) is weak, a two-pronged approach could be adopted.

First, for those PACSs that are relatively strong (audit grade 'A' and 'B') recommendations include:

- regular rating of SHGs;

- greater ease of accessing larger loans from PACSs by SHGs, for which the PACSs should not need to seek any clearances from the DCCB;
- capacity building of PACS staff to bring greater quality to their business planning, product development, SHG promotion skills;
- development of a strong credit management system for microfinance at the PACS level;
- SHGs allowed to retain at their level a majority of internal funds (rather than having to bank them with the PACS);
- compulsory deposit insurance.

Stronger SHGs should be allowed to retain a majority of internal funds at their level

Second, for those PACSs that are weaker but not completely unsound (C grade), in addition to the above, we recommend exploring new service models such as PACSs becoming business correspondents for commercial banks (which is likely to be possible only once PACSs are allowed to access refinance from more sources than just DCCBs), which can enable them to offer deposit services without the associated risks.

Overall, to move away from subsidy and also to ensure the rights of SHGs that are contributing to the deposit base of PACSs wherever linkages exist, modifications in the current Cooperative Societies Act are important. This should allow for a greater role in decision making and access to information by SHGs. For the PACSs regulatory change could also mean moving away from tied relationships such as those with upper-tiers.

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