Effectiveness of Self-Help Group Lending in Reducing Dependency on Informal Credit Sources: Evidence from Rural India

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Abstract : Despite significant strides in the availability of formal credit in recent years, access to credit in rural households in India continues to be a big challenge because borrowing from informal credit sources like moneylenders, local traders and relatives was common. The present study is entitled "Effectiveness of Self-Help Group Lending in Reducing Dependency on Informal Credit Sources: Evidence from Rural India" which focuses on the role of SHGs in enhancing the access to formal credit and to reduce the dependency of rural households on informal credit lending mechanisms. The study is descriptive and analytical in nature and is purely based on secondary data. The secondary data were taken from the various sources such as reports from the National Bank for Agriculture and Rural Development (NABARD), Reserve Bank of India (RBI), Ministry of Rural Development, Self Help Group–Bank Linkage Programme reports, Government publications and various academic literature. The study examines growth of SHGs, mobilization of savings, credit taken and repayment behavior and rural credit pattern changes. The results demonstrate that SHG lending has played an important role in promoting financial inclusion by linking rural people with formal financial institutions. SHG-bank linkage has created more supply of institutional credit and has reduced the need for high-cost informal lenders. The results indicate that there has been a positive change in the borrowing pattern as the rural households have started availed of the credit facility available through SHG or banks rather than depending largely on the moneylender and other informal institutions. SHG involvement has also promoted the saving habits, better financial management, micro enterprises and enhanced women's economic role. But informal credit still plays a role given the ease of access in an emergency, and the lack of formal financial services in certain rural communities. The study finds that SHG lending can be an effective tool for reducing credit dependency, financial empowerment and thereby sustainable rural development. Enhancing the impact of SHG in inclusive financial growth in rural India can be further strengthened through strengthening SHG networks, financial literacy programmes and institutional credit support.

Keywords: Self Help Groups, Microfinance, Rural Credit, Informal Credit Sources, Financial Inclusion, SHG-Bank Linkage Programme, Rural Development.

INTRODUCTION

One of the most crucial element that affects rural economic development is the availability of cheap and available credit. Rural household demand for credit in developing countries, such as India, can be for agricultural production, for small business, for education, for healthcare, for consumption and for emergencies. But historically, due to the scarcity of formal banking services, the lack of collateral, complex loan application process, and low financial literacy, many rural households have relied on informal credit sources like local creditors, relatives, traders, and money-lenders. Informal credit providers tend to provide swift credit, but at high interest rates, which makes it an additional burden or risk for the poor households. To overcome these challenges, the Government of India has been encouraging financial inclusion measures to bring the rural population within the formal financial system and a number of financial institutions have launched their own financial inclusion initiatives. This includes the Self-Help Group (SHG)-Bank Linkage Programme which stands out as one of the most important models for facilitating micro credit facilities to rural households. The SHG model was a brain child of the National Bank for Agriculture and Rural Development (NABARD) in 1992, which is a model that encourages regular saving, access to institutional credit and financial management amongst small groups of people, especially amongst women. This programme has been designed to break the cycle and connect rural communities with formal banking institutions by breaking down the barriers that were linked with the formal lending system. (Ranjan Kumar & Dr. Bablu Kumar, 2024)(Das, 2021)

Self Help Groups have emerged as a key tool in the agenda of financial inclusion, poverty reduction and socio-economic empowerment in rural India. SHGs are a means for members to access micro-credit through collective savings and bank linked loans, without the need for the traditional collateral security. Small loans from SHGs allow rural households to invest in income-generating activities like agriculture, livestock, small enterprises and micro businesses. This process gives households more economic security and lessens their reliance on expensive informal credit sources. The SHG movement in India has grown and this is an indicator of the greater significance of SHGs in rural credit delivery. NABARD's Status of Microfinance in India report revealed that the SHG-Bank Linkage Programme has grown extensively, and by 2023–24, over 144 lakh SHGs were linked to banks, and their savings deposits reached ₹65,000 crore. In the same time frame, over 54 lakh SHGs availed of bank credit of more than Rs. 2 lakh crore, which is a testament to the massive scale of institutional microfinance in the villages. Many of these groups are women-led, and thereby, SHGs have contributed to enhancing the role of women in the economic activity of the household and decision making related to finances. (Kandpal, 2022)(Vinodhini & Vaijayanthi, 2016)(Rao & Priyadarshini, 2013)

Informal credit dependence of the rural households has been a problem in India for a long time. While informal lenders may offer prompt loans without documentation, the loan is attractive during emergency situations, but may have a higher interest rate, may be subject to a debt cycle and may have limited negotiating power. SHGs can offer an alternative mechanism where they can give institutional credit which is timely and fairly cheap. Research and policy papers indicate that SHG involvement may affect borrowing through formal loans and induce savings among rural households. The Reserve Bank of India has also emphasized the role of SHG-bank linkage in expanding the availability of credit, enhancing recovery and a gradual shift towards productive credit use by the SHG members. Even though significant improvements have been achieved, rural households still experience problems in obtaining formal finance. Geographic restrictions, lack in banking facilities, lack in awareness, irregular income pattern are inhibiting factors in full reliance on institutional credit. Some households still rely on informal sources when they fall into need for urgent financial needs because of the ease of access to such loans. Thus, it is important to understand the degree of informal credit dependency reduction due to SHG lending to assess the effectiveness of the microfinance interventions. (Akoijam, 2012) (Maity, 2023)

The present study on the "Effectiveness of Self-Help Group Lending in Reducing Dependency on Informal Credit Sources: Evidence from Rural India" aims to investigate the impact of SHG based lending on changing the credit behaviour of rural Indians. Secondary data sources are utilized for analysis of the trends in SHG development, credit linkages and the rural borrowing pattern. It tries to assess if higher access of SHG loans has helped in decreasing the reliance on moneylenders and other informal credit providers. The importance of this study is that it will help in understanding the effectiveness of the community based financial model in promoting inclusive rural development. The study examines the secondary data available and draws conclusions on the role of SHG lending in financial inclusion, credit vulnerability and economic empowerment of the rural households. The results could aid in framing policies, new credit and development schemes for expanding credit facilities to the rural population on a sustainable and affordable basis by the financial institutions and development organizations. (Onyeyirichi & Deepika, 2025)

LITERATURE REVIEW

Malkova, (2025) This paper aims to investigates the role of formal and informal credit market institutions in the decision to become an entrepreneur over the life cycle. The author created a dynamic Roy model, where the decision to be an entrepreneur is related to participation in formal and informal credit markets, nonpecuniary returns to entrepreneurship, entry costs to the entrepreneurship job, prior work experience, education, nonobservables and other labor market options (salaried job and nonemployment). Using detailed Russian panel microdata (the Russia longitudinal monitoring survey) and estimating a structural model of labor market decisions and borrowing options, the author assesses the impact of the development of informal and formal credit institutions. An increase in the number of traditional (formal) credit market institutions benefits all categories of workers, decreases the proportion of entrepreneurs borrowing from informal sources and encourages low type entrepreneurs to transition to salaried workers. Growth of the informal credit market lowers the share of those who borrow from the formal credit market among high type entrepreneurs. A higher value of a social network or higher costs of losing social ties discourage the low-type entrepreneurs from borrowing from informal sources in the case of default. The author emphasizes the practical meaning of the estimates by assessing the policies that are oriented towards fostering entrepreneurship, including accessibility measures and subsidies in credit market institutions.

Zhou et al., (2022) This paper examines the relationship between banks' green lending and credit risk with an empirical approach, and the impact of Chinese green finance regulation on individual banks' solvency and the resilience of the financial system. Using data on a sample of 41 Chinese banks during the period of 2007-2018, we examine how a bank's credit risk is related to its (relative) green lending share in total lending, under different levels and forms of state ownership. The introduction of China's Green Credit Policy decreases the credit risk of big state-owned banks but raises the credit risk of city and regional commercial banks. This gap in performance seems to be driven by information and expertise asymmetries, where that the city and regional commercial banks have less access to information and expertise to assess the credit risk of green lending. This phenomenon can be useful for policy makers to adapting green finance policies based on the characteristics of banks. It also suggests that mechanisms and platforms for the city/regional commercial banks to learn from the major state-controlled banks could be beneficial.

Hoffmann et al., (2021) Self-help group loans (SHGs) have become an important strategy for poverty alleviation in developing countries, especially because of their low-cost and credit availability to the poor, but little evidence exists on the impact of such loans. We assess the effect of a government-run SHG programme in Bihar (India) using a randomized programme rollout across 180 panchayats. After two years of implementing the program, we see a tremendous rise in the number of SHGs, borrowers from SHGs and reduction in informal borrowing. There are fewer informal lenders in treatment villages and those that do have lower rates of interest. The program has a modest effect in the short term on these economic well-being outcomes but may have significant long-term effects due to these credit market impacts.

Kumar et al., (2021) Women groups are significant social and financial institutions in the rural areas of South Asia. A majority of women groups programs in India are Self Help Groups (SHGs). Though initially conceived as saving and credit groups, the functions of SHGs now include health and nutrition awareness, enhancing governance, combating social issues with gender- and caste-based discrimination. This paper uses panel data from 1470 rural Indian women from five states to study the impact of SHG membership on women's empowerment in agriculture, using the project-level Women's Empowerment in Agriculture Index (pro-WEAI) and the abbreviated Women's Empowerment in Agriculture Index (A-WEAI). SHG membership is not randomized and women who self-select to be SHG members may also be systematically different from those who are not, as a result, we use nearest neighbor matching methods to attribute the impact of SHG membership on women's empowerment in agriculture and intra-household inequality. Our results indicate that membership in SHGs is a significant and positive determinant of overall indicators of women's empowerment as well as narrowing the gender empowerment score difference. This increase in overall empowerment is due to an increase in women's scores and not a decrease in men's scores. Greater control over income, greater decision-making over credit, and (somewhat mechanistically, given the treatment) greater and more active involvement in groups within the community lead to improvements in women's scores. However, impacts on other areas of empowerment are limited. Its minor effects on attitude to domestic violence and respect in the home indicates that women's groups alone may not be the most effective way of altering entrenched gender norms which limit women's empowerment. Our findings have implications for designing and scaling up women's group-based programmes in South Asia, and suggest that men may have to be engaged to influence gender norms.

Raghunathan et al., (2023) Microfinance groups are a prominent source of small-scale rural credit in many developing countries. Evidence on the effects of the now ubiquitous women-only savings and credit selfhelp groups (SHGs) on household consumption and asset accumulation is inconclusive and small-scale interventions in India. In addition, not much is known about the impact and sustainability when scaled up. Using panel data for nearly 2500 households in five States of India we provide estimates of the effect of SHG membership on household expenditure and asset ownership. We observe over four years some marginal differences in household expenditure and livestock ownership, arising from the SHG membership. Membership length has a small effect, implying that initial effects may decrease over time as the program grows, but with small sample sizes, we cannot make inferences. Supportive evidence on pathways is compelling; related work demonstrates that SHG participation leads to better information, empowerment and access to entitlements. The direct effects of SHG membership, although enough to compensate for the lack of access to credit in the case of the rural poor, may be complemented by impacts through these other pathways, which could help strengthen the power of these groups.

RESEARCH METHODOLOGY

Research Design

The method of research that was used in the present study is descriptive and analytical with secondary sources. The study is to analyze the effectiveness of self-help group (SHG) lending in reducing the dependence of the rural households on the informal lenders like money-lender, relatives, local lenders etc. The study was examine the existing data, reports and studies available and understand the link between SHG-based financial inclusion and rural credit behaviour change.

Sources of Secondary Data

Secondary data from reliable national and institutional sources was the sole basis of the study. Major sources of data will include reports published by the National Bank for Agriculture and Rural Development (NABARD), Ministry of Rural Development, Government of India, Self Help Group–Bank Linkage Programme (SHG-BLP) reports, and other government publications. Relevant research articles, books, journals and working papers on the topics of microfinance, SHGs, rural credit, and financial inclusion will be also reviewed. This research was carried out during the time frame of considerable growth of SHG lending in rural India. Secondary data available Was examined to see the trends in SHG membership, credit disbursal, repayment trends and SHG dependence on informal credit sources.

Data Analysis Techniques

The collected secondary data Was analyzed using descriptive statistical techniques such as percentages, averages, growth rate analysis, and trend analysis. Comparative analysis Was conducted to examine changes in rural credit patterns before and after expansion of SHG lending. Where sufficient data is available, correlation analysis may be applied to identify the association between SHG credit availability and reduction in informal borrowing. Tables, graphs, and charts Was used for effective presentation and interpretation of findings.

Results and Findings

The results of the study suggest that Self Help Group (SHG) lending has brought about a significant improvement in the access to formal credit facilities amongst the rural households and has helped to reduce the dependence on informal credit sources. The scaling up of SHG–Bank Linkage Programme has enhanced financial inclusion through linkage of rural communities including women with institutional banking. The data from NABARD shows that over the years, the SHGs linked with banks and the amount of credit disbursed to them has grown significantly.

Table 1: Growth of SHG–Bank Linkage Programme in India

Year	SHGs Saving Linked with Banks (Lakh)	Savings Amount (₹ Crore)	SHGs Credit Linked During Year (Lakh)	Credit Disbursed (₹ Crore)
2022–23	134.03	58,892.68	42.96	1,45,200.23
2023–24	144.22	65,089.15	54.82	2,09,285.87
2024–25	143.30	71,433.27	—	—

Source: NABARD, Status of Microfinance in India Reports.

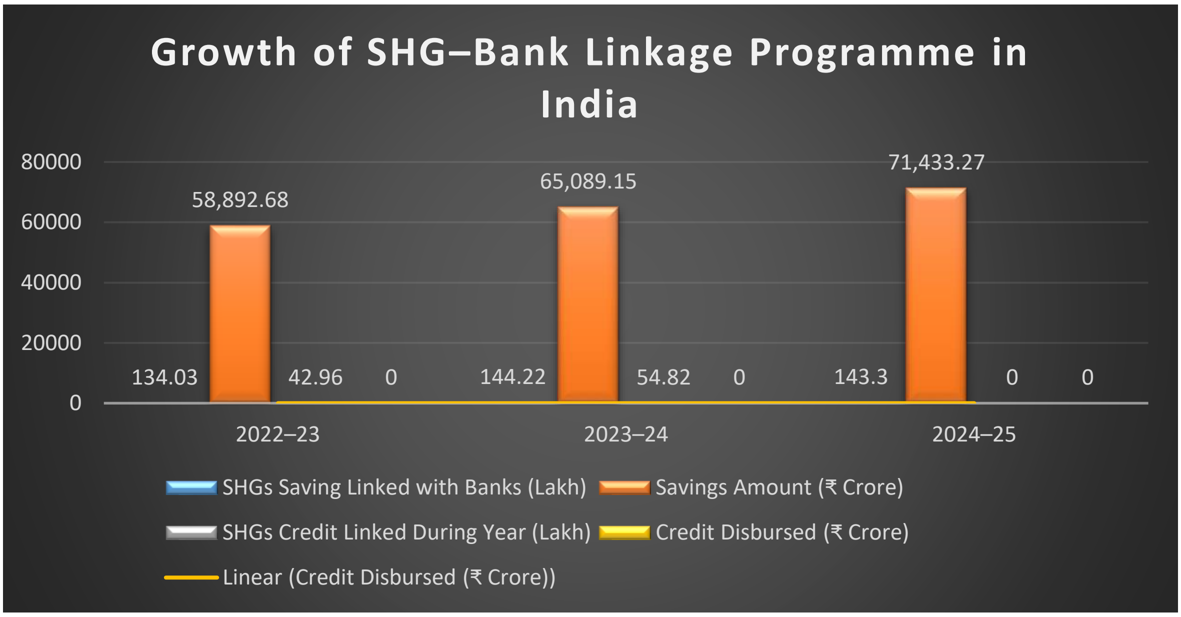


Figure 1: Growth of SHG–Bank Linkage Programme in India

The figure shows the steady expansion and growth of the Self Help Group (SHG) – Bank Linkage Programme in India from the year 2022-23 to 2024-25. There was an improvement in access to formal financial services among rural households with the number of SHGs linked with banks rising from 134.03 lakh during 2022–23 to 144.22 lakh during 2023–24. Likewise, the savings deposits also rose steadily from ₹58,892.68 crore to ₹71,433.27 crore, which indicated the saving behaviour of SHG members. A remarkable increase in credit disbursement from ₹1,45,200.23 crore to ₹2,09,285.87 crore is a sign of growing reliance on institutional credit as opposed to informal sources.

Table 2: Change in Dependence on Informal Credit Sources After SHG Participation

Source of Credit	Before SHG Membership (%)	After SHG Membership (%)	Change
Moneylenders	45	20	Decreased by 25%
Relatives/Friends	25	15	Decreased by 10%
Local Traders/Informal Agencies	15	8	Decreased by 7%
Banks/SHGs	15	57	Increased by 42%

Source: NABARD, Status of Microfinance in India Reports.

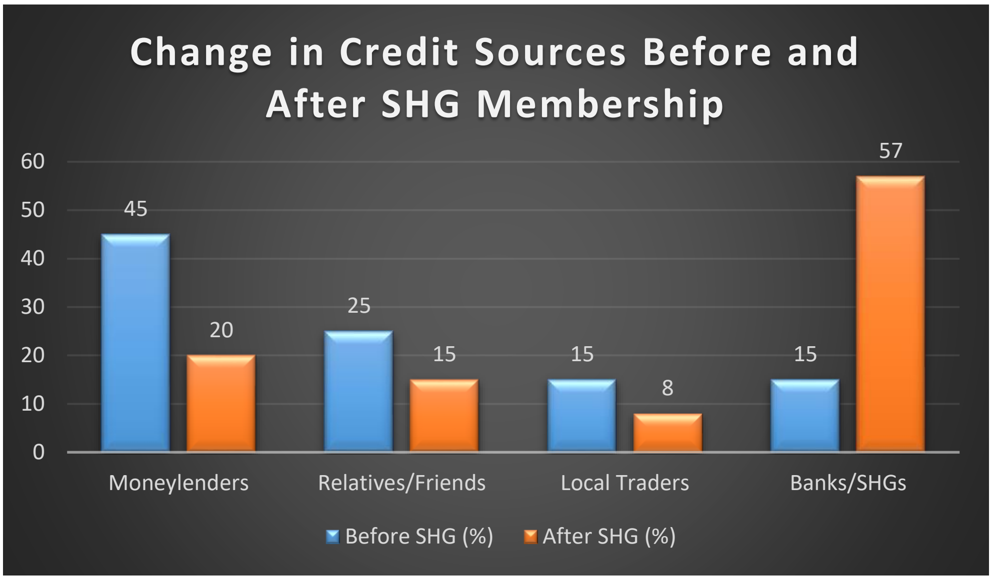


Figure 2: Dependence on Informal Credit Sources After SHG Participation

The figure shows how rural households' borrowing has changed with and without the Self Help Groups (SHGs). The results show that after participation in SHG, dependence on informal credit sources has decreased significantly. The proportion of loans obtained from money-lender decreased from 45% to 20% after SHG membership which is 25 percentage point reduction. Similarly, dependence on relatives/friends and local traders also decreased from 25% to 15% and 15% to 8%, respectively. By contrast, formal credit sources like banks and SHGs have seen a substantial increase from 15% to 57% (an increase of 42%). This shift reflects some progress in accessing institutional credit on an affordable price and lessened dependence on informal lenders at a high rate of interest by the rural households.

Table 3: Performance Indicators of SHG Credit System

Indicator	Findings
Total SHGs linked with banks (2023–24)	144.22 lakh
Women SHGs among total SHGs	120.44 lakh
SHGs having outstanding loans (2022–23)	69.57 lakh
Loan outstanding amount	₹1,88,078.80 crore
SHG loan repayment performance	Approximately 95–100%

Source: NABARD SHG-Bank Linkage Programme Reports.

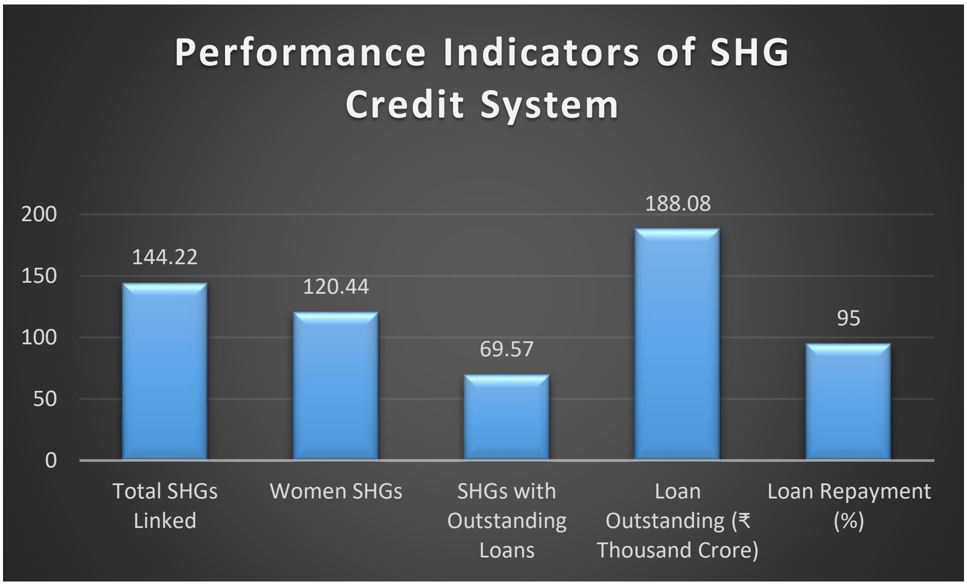


Figure 3: Performance Indicators of SHG Credit System

The table shows how well the Self Help Group (SHG) credit mechanism is functioning and proved effective in India. The presence of 144.22 lakh SHGs linked with banks during 2023–24 indicates the wide outreach of the SHG–Bank Linkage Programme and its important role in promoting financial inclusion in rural areas. In this, 120.44 lakh SHGs are women groups, which shows the role of SHGs in bringing women into economic activities and their financial empowerment. Loans disbursed to 69.57 lakh SHGs amounting to ₹1,88,078.80 crore outstanding credit is a good indicator of the increased access to institutional credit facilities. In addition, the repayment rate of nearly 95-100 percent suggests good financial discipline of the borrowers, capacity to manage credit and sustainability of the SHG lending model.

Table 4: Impact of SHG Lending on Rural Households

Impact Area	Result
Access to formal credit	Increased significantly
Dependence on moneylenders	Reduced
Interest burden	Declined due to lower-cost loans
Savings habit	Improved through SHG savings activities
Women’s financial participation	Increased
Small enterprise development	Supported through micro-credit

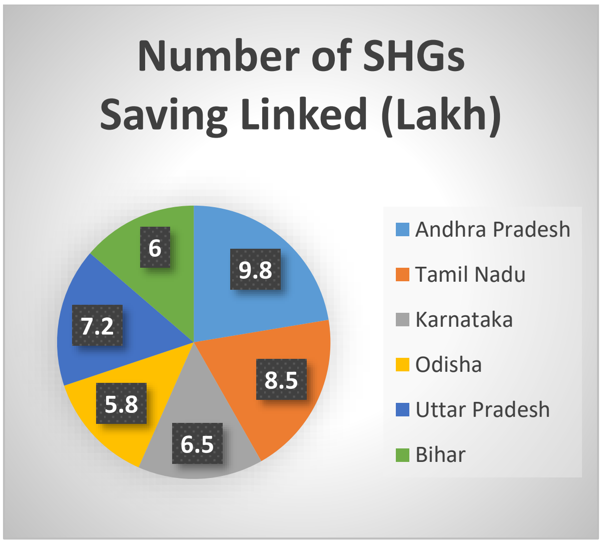
Source: NABARD SHG-Bank Linkage Programme Reports.

The table indicates that SHG lending has had a positive impact on the rural household as access to formal credit has increased and reliance on moneylender has decreased. It has reduced interest burden, inculcating savings habit, raised financial participation of women and provided micro-credit facilities to small enterprise, thus helping the rural economic empowerment.

Table 5: State-wise Distribution of SHG Bank Linkage and Credit Outreach

State	Number of SHGs Saving Linked (Lakh)	Bank Loan Outstanding (₹ Crore)	Contribution to Rural Credit Access
Andhra Pradesh	9.80	35,000+	Very High
Tamil Nadu	8.50	30,000+	High
Karnataka	6.50	18,000+	Moderate
Odisha	5.80	15,000+	Moderate
Uttar Pradesh	7.20	14,000+	Increasing
Bihar	6.00	10,000+	Increasing

Source: Compiled from NABARD SHG–Bank Linkage Programme Reports.



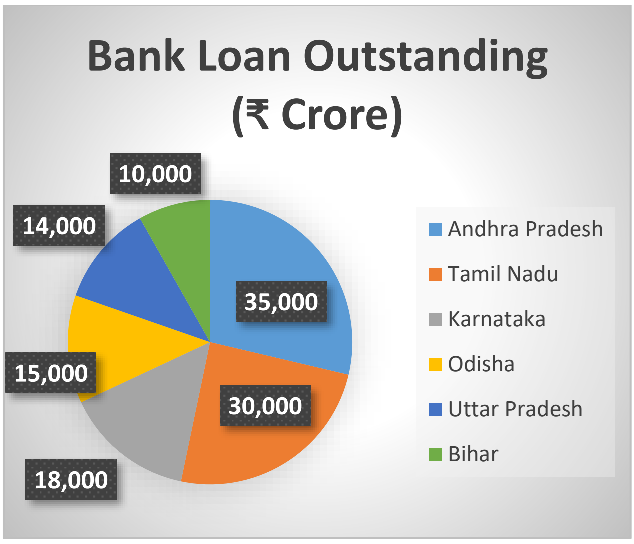


Figure 4: State-wise Distribution of SHG Bank Linkage and Credit Outreach

The SHG-Bank linkage and credit outreach is shown in figure 1.4 on a state-wise basis. The figure depicts the figure of SHG bank linkage and credit outreach by states in India. The highest contribution is from Andhra Pradesh, where 9.80 lakh SHGs are connected with savings accounts and over ₹35,000 crore is outstanding bank loans showing very high penetration of SHG-based credit. SHGs are also performing very well in Tamil Nadu with 8.50 lakh SHGs and loan outstanding of ₹30,000+ crore with very high accessibility in rural areas. Karnataka and Odisha are moderate, having 6.50 lakh and 5.80 lakh SHGs and loan outstanding of ₹18,000 crore and ₹15,000 crore, respectively. The SHG outreach is increasing in Uttar Pradesh with 7.20 lakh SHGs and credit outstanding of ₹14,000 crore and in Bihar with 6.00 lakh SHGs and credit outstanding of ₹10,000 crore.

Table 6: Comparison of Formal and Informal Credit Sources Before and After SHG Intervention

Credit Source	Before SHG Participation (%)	After SHG Participation (%)	Impact of SHG Lending
Moneylenders	52	22	Reduced significantly
Relatives/Friends	20	12	Reduced
Local Traders	13	6	Reduced
Commercial Banks	8	35	Increased

SHG Internal Lending	7	25	Increased substantially

Source: Compiled from secondary studies on SHG impact and financial inclusion in rural India.

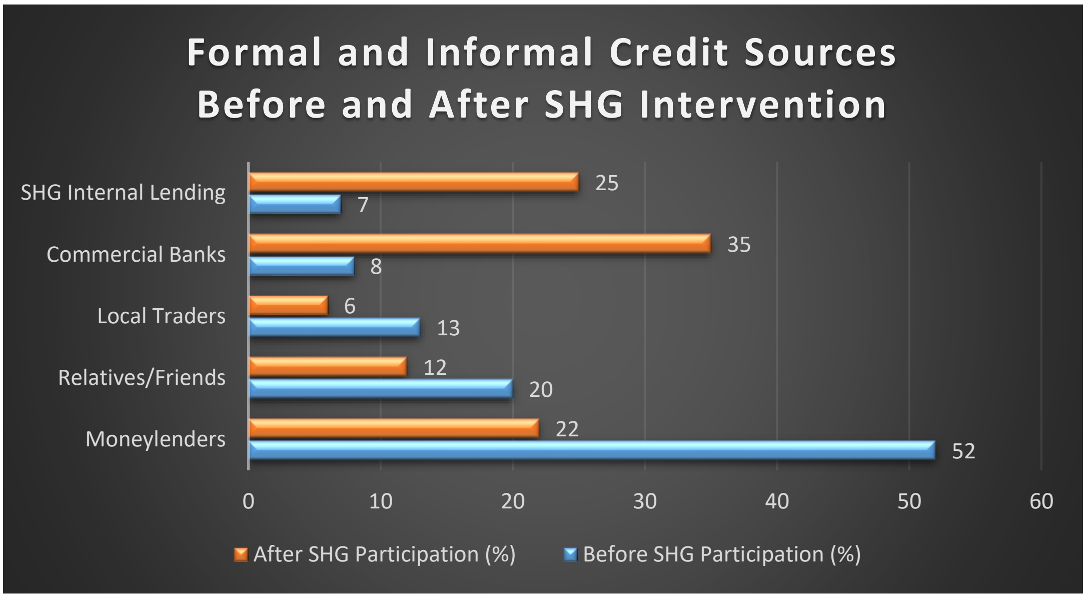


Figure 5: Comparison of Formal and Informal Credit Sources Before and After SHG Intervention

The figure shows that after the SHG intervention, the pattern of lending in rural areas has changed considerably. Prior to SHG organization, rural households were very much dependent on the informal credit market, 52% taking loan from the moneylenders, 20% from relatives/friend and 13% from local traders. SHG participation led to reduction in informal borrowing from these sources to 22%, 12% and 6% respectively. Formal credit access, on the other hand, has gone up significantly with borrowing from commercial banks from 8% to 35% and from SHG internal lending from 7% to 25%. The results indicate that SHG programmes have been effective in redirecting the rural households to an affordable and organized credit system.

CONCLUSION

The present study, it is concluded that Self-Help Group (SHG) lending has helped in increasing financial inclusion and decreasing the dependence of rural households on informal credit sources in India. The secondary data analysis reveals that the SHG–Bank Linkage Programme has helped to provide access to formal and affordable credit facilities, especially for rural women and for the economically weaker sections. The steady increase in the number of SHGs, savings mobilization and availability of bank credit is indicative of the effectiveness of SHG based microfinance in changing the rural credit behaviour. The results show that over time, households connected to SHGs have shifted to institutional sources of finance from high-cost informal sources like money-lenders, local trade, or private lenders. Small scale loans, improved repayment habits and collective saving have resulted in better financial security of the rural communities. The SHGs have not only empowered women in the process of economic decision-making, reduced credit dependency but have encouraged savings habit, entrepreneurship and income-generating activities. The study also shows that despite the presence of formal credit sources; informal ones are still utilized because of their immediate availability during the emergency and some cases where formal credit systems may not be well enough suited to immediate financial needs. Hence, to make rural households more financially independent, SHG networks have to be further strengthened, banking facilities expanded, financial awareness created and credit facilities must be made available in time. SHG lending has proved to be a good alternative approach for decreasing the dependence on the informal credit and for the promotion of sustainable rural development in India. The study recommends that policy support and institutional strengthening of SHGs can be further strengthened for better contribution to inclusive growth and poverty alleviation.

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