Micro Finance in India: Emergence and Growth

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Poverty and unemployment remains two major challenges of development in India. There is a vast unmet gap in the provisions of financial services to the poor in India. Majority of the poor population depends for credit needs on informal sources of finance for livelihood support and consumption purposes. India is an agrarian economy where 74.3% people live in villages. The country had a population of 1 billion in 2004. Of this, 35.3% people lived under the earning of Rs.47.00 per day & 80.6% people lived under Rs.94.00 per day. The unemployment rate was 4.3% in 2000 and informal sector employed at 36%. The World Bank has found that on an average, 11 steps over a period of 89 days are required to be completed to begin a business and it takes 67 days and 6 required procedures to obtain a business registration member. This interesting fact points out the prevailing circumstances.

Learning from the example of Grameen Bank Bangladesh, many non-government organizations (NGOs) in India came forward to provide financial services to the poor people through micro finance in 1990s. The term Microfinance means 'very small credit facilities provided to the needy and most poor section of the society'. It is not just a tool for poverty eradication but also for individual development, growth in entrepreneurial activities in economically backward areas.

The decade of 1990 has shown growth in micro finance sector as well as in information and communication technology (ICT) in India. It is estimated that now about 1000 microfinance institutions (MFIs) /NGOs are providing microfinance services in India through different delivery mechanism. Over a period of time certain best practices of delivery have emerged in India based on their clientele, focus area, interest rate, savings linkages, collateral, coverage and organizational legal structure. Micro Credit has been changing people's lives and revitalizing communities since the advent of Micro Finance Service. The Micro-Finance year 2005 has called for identifying and building the entrepreneurial spirit existing in communities. In the present paper, an overview of the microfinance sector in India has been covered to understand its emergence and growth.

Introduction

The impressive recent growth of certain sectors of the Indian economy is a necessary but insufficient condition for the elimination of extreme poverty. The idea of Microfinance arose in Asia as a reaction to the abject rural poverty prevalent in various countries such as India and Bangladesh. Microfinance is an emerging discipline in the financial world today. It is gaining importance by leaps and bounds not only in India but also internationally. Microfinance was born in the east. Within the microfinance industry, the term micro finance institution has come to refer to a wide range of organisations dedicated to providing these services, such as NGOs, credit unions, co-operatives, private commercial banks, and NBFCs.

Microfinance is revolutionary in the sense that it aims at servicing the poorest of the poor, who were hitherto considered unfit for anything except charity. The Microfinance concept is based on group lending. Income of many agrarian households is neither adequate nor stable. An individual poor person is an isolated island by himself / herself. Large number’ of small loans are required to minimize the operational cost. Bankers know it well that these poor people are more honest and sincere than others. These groups neither have the capacity to provide collaterals nor do they expose greater risk of non-payment than the other urban / metro large borrowers. The term micro credit refers to small size of thrift, small size of loan, repayment is made in small period with no collateral or guarantees. It is a system for providing small loans to poor entrepreneurs, typically self employed and running a home based business. As the name suggests, the term Microfinance means 'very small credit facilities provided to the needy and most poor section of the society'. It is not just a tool for poverty eradication
but also for individual development, growth in entrepreneurial activities in economically backward areas. However, now the microfinance revolutionaries are setting their sights on a more ambitious goal, of trying to create a more professional, inclusive financial system that reaches deep into rural and urban areas. At the same time, microfinance is moving fast its small business base to offer a wide range of financial services including savings, insurance, money transfers and broad array of loan options, to the poor. Micro Credit has been changing people's lives and revitalizing communities since the advent of Micro Finance Service. Majority of people as, micro finance beneficiaries, are successful in augmenting their income. Their needs and requirements are constantly changing with the changes in the surroundings and are in fact, growing out of proportion. Therefore, demand for credit exceeds the supply at any point of time. Need is also escalating in the areas of cash transfers and non-financial requirements, including housing. Micro finance is a vehicle to reach SC / ST / OBC. The horizon is seen and can be touched upon to bring the neglected and oppressed poor people into lit zones.

Review of Literature

History

The modern origin of microfinance dates back to mid '70s. Among the key innovators was Professor Muhammad Yunus of Bangladesh who advocated loaning to very poor people, especially women. He started the Grameen Bank project in 1976 and transformed it into a bank in 1983. The bank now has 6 million borrowers - 90% of them being women and almost 2000 branches in 64,000 villages. The repayment rate for loans is 98% and bank has earned profit almost every year except for three years since its inception. The Grameen Bank experiment showed that it was possible to make profit while doing good. It gave one the opportunity to do good to oneself while doing good to others.(Jaiswal 2007)

The institutional initiatives taken in extending micro-credit in India after independence can be understood in conjunction with the growth of community development programme, rural banking and co-operatives. On 02 October 1952, Community Development Programme was formally launched in 55 community projects. During 1978-1990, many rural development programmes of poverty alleviation were started under the umbrella scheme of Integrated Rural Development Programme (IRDP) with the purpose for creating income-generating assets along with the employment opportunities for the beneficiaries. From 1991 onwards, emphasis is given on employment generation.

At the banking level, after independence 14 major commercial banks were nationalized in July 1969 with the purpose to develop a multi-agency approach involving commercial banks of the country to play a dynamic role in the process of developing rural and backward areas of the country by providing institutional credit. In the same year, Reserve Bank of India (RBI) launched a Lead Bank Scheme with the purpose of area approach of development. Regional Rural Banks Act came into existence in 1976, which was targeting weaker sections of society. National Bank for Agriculture & Rural Development (NABARD) was established on 12 July 1982, for supporting institutional credit. It is an apex bank of refinance for rural credit as well as co-ordinating agency for various departments dealing with rural credit. After independence, First Five-Year Plan recognised co-operatives as major instrument of planned action in democracy and subsequently a Rural Credit Survey Committee was formed in 1951, National Co-operatives Union of India in 1961 and National Co-operative Development Corporation in 1963. National Co-operatives Policy Resolution was passed in 1977. During 1979-81, 'All India Rural Credit Review' was done to make arrangements of institutional credit for agriculture and rural development. In 1991, Chairperson of Model Act for Co-operatives, Mr. Brahm Prakash submitted its report.

The number of commercials banks in India by March 2003 is 288 that includes 196 Regional Rural Banks (RRBs) with total 68,561 branches out of which 32,406 are in rural areas. As on March 2002, there are 28 State Co-operative Banks with 797 branches, 367 Central Co-operative Banks with 12,128 branches and 90,840 Primary Agriculture Credit Societies (PACS). However, studies conducted by Ansari (1980), Jain (1984), Chaturvedi & Mitra (1987) and Ray (1992) show that the
rural development programmes were centrally invented, lacking participation of local level institutions, politically motivated and having leakage, miss-appropriation and heavy administrative expenses. Consequently, assets of poor quality were provided to the beneficiaries for productive purposes. According to Basu (1979), Chippa (1987) and Rayudu (1992) rural credit schemes were politicised. According to Choudhari (1972 et al.), Attwood (1984), Baviskar & Attwood (1984) and Attwood & Baviskar (1987) social system has bearing for the success or failure of co-operatives. Access to credit by poor people through institutional framework is difficult in India, irrespective of the huge network of these institutions.

By learning from the example of Grameen Bank, Bangladesh, many NGOs in India came forward to provide financial services to the poor. In early 1990s, NABARD started an experiment with MYRADA-NGO in Karnataka by promoting groups, mobilising their savings and linking them with banks for credit support. Later on, NABARD replicated this project all over India under the SHG-Bank Linkage Programme and many NGOs came forward to implement this project with the co-operation of banks. In 1994, following the success of NABARD, Small Industries Development Bank of India (SIDBI) also came forward to provide bulk lending to NGOs for on lending to groups / individuals. Ministry of Human Resource Development, Government of India established Rashtriya Mahila Kosh (RMK) for providing loan to NGOs to on lend to poor women. Other National and State Financial Corporations also enter into the microfinance sector. International funding agencies also started microfinance services in India through their projects. It is estimated that about 1000 MFIs / NGOs are providing microfinance services in India through different delivery mechanism.

In India, different models have emerged in microfinance delivery based on their clientele, focus area, interest rate, savings linkages, collateral, coverage and organisational/legal structure. These models can be classified under four broad approaches namely; group promotion approach, MFI approach, MED approach and social development approach. Singh (2002, 2004) has developed theoretical framework of these approaches over a period of time based on the fieldwork, teaching and training experiences.

The group promotion approach is based on the premise that NGOs or banks promote groups and provide them services of microfinance. This ultimately leads to build the capacity of groups, in terms of savings mobilisation, linking them with credit and providing technical support to the members of the group, for starting viable micro-enterprises. SHG-Bank Linkage Programme in India has predominantly brought out the significant group approach for the growth and development of micro finance sector in India. In this programme, there are three models of linkage. These are: i) banks directly promote SHGs and provide them credit, ii) NGO acting as Self-Help Promoting Institution (SHPI) and linking SHGs with banks for credit support and iii) NGO acting as intermediary of MFI and on-lending money to the SHGs.

The MFI approach is based on the premise that Apex Financial Institutions (AFIs) provide bulk lending, soft loan and some grant to such NGOs which can act as MFIs and on lend to the poor people / SHGs / Federations / smaller NGOs. These MFIs stimulate credit demand of the poor people. They also provide technical support to the beneficiaries to ensure proper utilisation of loans and repayment. At the same time, they meet their cost of funds, cost of credit management and cost of default, through the spread of interest and generate surplus for the viable operation of microfinance. MED approach refers to the package of services, policies, programmes and institutions, intended to develop micro-enterprises including lending and savings. Microfinance sector is providing help to solve the problem of credit for developing micro-enterprise. Thus, microfinance for micro-enterprise development has emerged as important approach in India.

The social development approach of microfinance is based on the premise that people should earn money by investing in viable micro-enterprises. They should earn profit from their enterprises. Major share of the profit should be reinvested in enterprises for their growth. The other share of the profit should be spent on social development i.e. health, education, housing, sanitation etc. By earning profit from the viable micro-enterprises, people will increase their paying ability for services delivered to them under different social development projects run by NGOs and Governments.
Role of AFIs has been very significant, since the emergence of microfinance sector all over world. It is also true in case of India. In India besides NABARD, SIDBI, RMK, other national financial institutions and international agencies have also made their entry in micro finance sector by providing loans and grants to NGOs for different income generating projects as well as for incorporating micro finance component in the service delivery projects of social development. (Singh 2008)

Indian Scenario

India is an agrarian economy where 74.3% people live in villages. The country had a population of 1 billion in 2004. Of this, 35.3% people lived under the earning of Rs.47.00 per day & 80.6% people lived under RS.94.00 per day. The unemployment rate was 4.3% in 2000 and informal sector employed at 36%. The World Bank has found that on an average, 11 steps over a period of 89 days are required to be completed to begin a business and it takes 67 days and 6 required procedures to obtain a business registration member. This interesting fact points out the prevailing circumstances. There is rigidity in laws with regards to sacking an employee, coupled with the problems of rigid working hours and difficulty in hiring a new, capable worker. The credit information index used by the World Bank speaks of "Scope, access and quality of credit information available through public registries on private bureaus". In India there is little credit information available, but our laws / regulations for collateral and bankruptcy are in the midway of the scale 0-10 with regards to access to credit. Bankruptcy cases take approximately 10 years to finalize. The cost is estimated to be 8% of estate value. (Roy 2007)

Microfinance institutions (MFIs) have, emerged as key providers of financial services for the poor. Majority of Indian MFIs are not-for-profit organizations that facilitate the formation of Self-HelpGroups (SHG) and link them with formal banks, often as a subset of activities that extend beyond microfinance. Championed by the National Bank for Agriculture and Rural Development (NABARD), this model accounts for 70% of microfinance in India. SHGs typically consist of 15-25 members and utilize revolving savings funds. The size of individual loans is determined either by the volume of individual savings or by the group's savings as a whole, and interest rates are determined by members. SHGs may borrow directly from an MFI / and are often organized into federations to obtain external funds in bulk. Currently, the predominant financing model for SHGs is one in which the MFI acts as facilitator between banks and SHGs, while in other cases lending goes to SHGs through the financial intermediation of MFIs. In addition to the SHG model, the remaining MFIs employ the Grameen (group lending) model or offer individual loans. With 75 million poor households potentially requiring financial services, the microfinance market in India is amongst the largest in the world. It is gaining importance by leaps and bounds. Estimate of household credit demand varies from a minimum of Rs. 2,000 to Rs. 6,000 in rural areas and Rs.9,000 in urban settings. Given that 80% of poor households are located in rural areas, total credit demand ranges between RS.255 billion and RS.500 billion. Supply of microfinance services, however; falls significantly short of demand. Planet Finance reports that in 1997-1998, banks disbursed RS.97 billion in credit to the poor, while MFIs and NABARD's SHG Bank-Linkage program disbursed, Rs.1.4 billion covering 20% of the estimated demand. More recent data suggest that while the gap between supply and demand may be shrinking, it continues to exist. In March 2003, outstanding loans of the SHG Bank-Linkage Program amounted to Rs.10 billion while MFIs held RS.2.4 billion in loans outstanding. Moreover, SHG member households received an average of Rs.1766 in credit. Hence, not only did the bulk of demand remain unmet, but borrowers generally received smaller loans than required.

Additionally, microfinance services remain predominantly in the form of credit and do not address the poor's need for saving and insurance services. Regulation prevents most MFIs from mobilizing savings; and, insurance schemes are limited. In terms of scope, the microfinance sector in India is concentrated in the southern states of Andhra Pradesh, Tamil Nadu, Karnataka, and Kerala, with Andhra Pradesh alone encompassing 50 to 70% of microfinance activities. Banks, prompted by priority lending targets and profit motivation, are increasingly investing in microfinance. To date, however, they have shown: little or no interest in retail microfinance, and the predominant providers of microfinance services in India continue to be SHGs and MFIs. ICICI, the largest private bank in
India, has begun to partner with MFIs to serve their clients and in some cases has bought out their portfolio in lieu of opening microfinance retail branches directly. (Jaiswal, 2007).

**Self Help Group**

A Self Help Group can be defined as "... a small economically homogenous and affinity group for rural poor voluntarily coming together..." The salient features of a SHG are as follows: (Rehman & Siddiqui, 2007)

1. Group members save small amounts regularly and voluntarily agree to contribute to a common group fund.
2. Within the group they have simple and responsive rules.
3. Decision-making is collective and is based on consensus. Conflicts, if any are resolved.
4. Democratic
5. Loans are provided for production as well as consumption purposes.
6. Loans are provided without collateral and interest rates charged are comparable to those of the market i.e. banks, cooperatives etc. However these interest rates are lower than those charged by the moneylender.

**Operations within a SHG.**

Membership of a SHG smoothens an individual's conduct and makes him more reliable both as a borrower and as a saver. It is also felt that the approach for poverty alleviation should be self-help rather than support, hence the term Self Help Group. Usually meetings are held at weekly intervals along with the Bank/NGO and the amount saved is deposited with the Bank/NGO, in the name of the group. Although the account is operated by the office-bearers of the group, all the operations viz.

<table>
<thead>
<tr>
<th>The following organizations are serving in Microfinance area:</th>
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<tbody>
<tr>
<td>Service Providers</td>
<td>Retail Outlet</td>
</tr>
<tr>
<td>Co-operative Banks</td>
<td>12,000</td>
</tr>
<tr>
<td>RRBs</td>
<td>14,000</td>
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<tr>
<td>Commercial Banks</td>
<td>60,000</td>
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<tr>
<td>Co-operative Credit Societies</td>
<td>90,000</td>
</tr>
<tr>
<td>Total</td>
<td>1,76,000</td>
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**National Initiatives**

Government agencies such as NABARD envisioned the role of Microfinance Institutions who linked SHGs primarily with banks. The number of borrowers through SHGs was expanding rapidly, especially after 2005 central government budget support to this sector. In his budget speech in February 2005, the Finance Minister promised to promote MFIs 'in a big way', and to help them act as intermediaries between banks and borrowers. He doubled, to Rs. 2 bn, a fund devoted to provide the MFIs with capital which was meant to help in causes such as organizing SHGs.

NABARD was established in 1982 as an apex bank to provide and regulate credit for the promotion and development of agriculture, small-scale industries, cottage and village industries, and handicrafts in rural areas, Its SHG Bank Linkage Program consists of encouraging the formation of SHGs and linking them with banks. Collaboration with external facilitators such as NGOs, MFIs, banks, and Government agencies is an integral aspect of the strategy. In addition to concessional refinancing for banks, NABARD provides policy guidance and capacity building support. Since its 1992 pilot project, NABARD has provided 16.7 million families with financial services through the formation and credit linkage of 1,079,091 SHGs as of March 2004, far exceeding its goal of one million SHGs by 2007. NABARD has since increased its target to 585,000 new SHGs by 2007. The Small Industries Development Bank of India (SIDBI) was established in 1990 as the main coordinator...
and principal financial institution for the promotion, financing, and development of industry in the small scale sector. The SIDBI Foundation for Micro Credit (SFMC) was established in 1999 to promote the growth and sustainability of the microfinance sector by providing a range of financial and non-financial services to MFIs, including loan funds, grant support, equity, and institution building support.

The SHG Bank linkage programme is the flagship micro finance intervention of NABARD. Starting with the NABARD lead pilot project in 1992 that aimed at promoting and financing 500 SHGs across the country, the SHG- Bank Lirikage strategy has come a long way. Nearly 2.23 million SHGs were provided bank-credit of over Rs. 1,13,975 million by march 2006. Almost 90% of groups are women groups. Over 35,290 bank branches at 48 commercial banks, 117 RRBs and 329 co-operatives were involved in financing these groups. (Jaiswal 2007)

A few Market Players and Their Orientations

With all the facilitating activities and initiatives to gain on opportunities, there seemed to be celebration times for all MFIs, especially for those operating in the rural areas of Indian state of Andhra Pradesh (Appendix Sa). In this context, the main players present in Andhra Pradesh’s microcredit industry are largely operating on three different fronts. (Anand 2008)

Major Demanders of the Fund for Serving the Need of the Credit Seekers

Share Microfin Limited (SML): A typical example of this kind is Uday Kumar's (founder) SML (Society for Helping Awakening Rural Poor through Education), a private sector MFI (started in 1992 and incorporated as a public limited company in April, 1999 in the form of an NBFC) without government support, which also operated in the states of Chhattisgarh and Karnataka. Its prime services are loan disbursement, business development services training, and consultancy. The main sources of fund for SML are loans and shareholder's capital, with Small Industries Development Bank of India (SIDBI) as the largest financier.

Bhartiya Samruddhi Finance Limited (BASIX): It is anew generation livelihood promotion institution established in 1996, working with over 150,000 poor households covering over 10,000 villages in 25 districts and six states of India. This NGO started as an NBFC was also operating almost on the same lines as SML, with its main aim to promote a large number of sustainable livelihoods for rural poor and woman by providing financial services and technical services in an integrated manner using loans and insurance as the prime vehicle. The main forms of funding for this institution are loans and shareholders' capital. The operating design of BASIX is geared towards providing a multiple set of services to rural poor households under one umbrella. This includes provision of microfinance services (savings, credit, insurance), livelihood promotion (opportunity identification, productivity enhancement, market linkages) and institutional development services (group promotion, capacity building, training, policy analysis). As on 31 December 2003, BASIX has disbursed loan of Rs. 2134 million, with outstanding of Rs. 623 million, by covering 158,860 clients. Its performing assets (as per RBI nom1S of 180 days past due) is 94 %, with 41 % of the loan amount in non-farm sector and 40 % for women.

The Swayamkrushi Woman's Development Mutually Aided Cooperative Thrift Society Limited (TSWDMACTSL): It operates as a cooperative working through credit unions, with almost the same objectives as that of BASIX. (started by YOC, its primary network) to link SHGs with banks. The main aim of this organization is to provide timely and self-sustained finance to its members apart from making these women real owners (through their shareholding in the organization) of the organization. Its main offerings are loans, voluntary savings, insurance, and shareholders' capital. SIDBI is the single largest fund provider for this MFI which looks for investments in the form of equity investments, loans, donations, guarantees, and capacity building grants. This institution specifically targets clients earning less than US$1/day and population in the bottom half living under the poverty line. For this purpose it uses targeting tools such as Means test, Participatory wealth and ranking, Housing index.
Pragati Seva Samiti (PSS): The prime focus of this NGO is to provide financial services to the socioeconomically disadvantaged sections. It also provides business development services, health support services, and education support services to its target community. With banks as its largest fund providers this MFI also looks for investments in the form of equity investments, loans in local currency, and capacity building grants. The institution specifically targets clients earning less than US$1/day and population living below the poverty line using targeting tools such as Means test, Participatory wealth ranking, and Housing index.

Star Youth Association (SYA): The main aim of this NGO established in 2002, is to provide financial services to the socioeconomically disadvantaged sections of the society. It does so by providing loans and insurance at such micro levels. Here also this institution looks for investments in the form of equity investments, loans in local currency, and capacity building grants. Further, this institution also specifically targets clients earning less than US$1/day and population living below the poverty line for which it uses targeting tools such as Means test, Participatory wealth ranking, and Housing index.

Payakaraopeta Woman's Mutually Aided Cooperative Thrift and Credit Society (PWMACTCS): This is again a cooperative organization working through credit unions since 1997, with the objectives to provide its members financial services in the form of loans, voluntary savings services, and insurance. Further, it also provides business development services, health support services, and other related services. With banks as the largest funding agency, the MFI also looks for investments in the form of loans in local currency, capacity building grants, and donations. As in the previous cases, this institution also specifically targets clients earning less than US$1/day and population living below the poverty line using targeting tools such as Means test, Participatory wealth ranking, and Housing index.

Swayam Krishi Sangham (SKS): This NBFC-affiliate, incorporated in 1997, is one of the fastest growing institutions in the business which has provided around $36 mn in loans for close to 275,000 clients in the drought-prone Deccan region of India. Starting from AP, its operations now cover many states in India and is growing at a rapid pace (last year its finance business grew by 300 percent with 99 percent on time payments). Its main services are income-generating loans, individual loans, mid-term loans, loan cover insurance, and others. Having Indian commercial banks as their largest fund providers, SKS also looks for investments in the form of equity investments, loans in local currency, and guarantees. The institution specifically targets population in the bottom half living under the poverty line using Housing index as the targeting tool.

DHAN Foundation:

DHAN Foundation was initiated in October 1997 and incorporated under Indian Trusts Act (1882) in January 1998. The Trust has been promoted with an objective of bringing highly motivated and educated young women and men to the development sector so that new innovations in rural development programmes shall be brought and carried to vast areas of the country and the people; especially the poor. The Foundation works towards bringing significant change in the livelihoods of the poor through innovation in themes and institutions. The three broad purposes for which the foundation stands are: development innovations, promoting institutions to reach scale and human resource development. DHAN Foundation aims to address poverty directly. It aims to reach out to thousands of poor in Tamil Nadu, Andhra Pradesh and Karnataka and would catalyze development in different parts of the country and elsewhere. Many innovative themes would be developed to address the poverty of the masses in rural, urban and tribal environments. (Singh 2008).

Microfinance has been promoted in different versions through various delivery channels. So far, the experience has been a mixed one with varying result across the states. However, The real potential of microfinance is far from being realised, owing to various institutional and political factors.

The major stumbling blocks in microfinance in India are:
1) Lack of awareness / education about microfinance.
2) Lack of enabling policy for MFIs.
3) Skill development.
4) Politicization of Government funded \ subsidized programmes.
5) Non availability of intermediary between the FLs and the borrower who lack collateral security.
6) High administrative cost where multiple intermediaries are involved.
7) Lack of skilled labour with the knowledge of local level accounting.
8) Highly disorganised and fragmented intermediation between FLs and the borrowers.
9) Dominance of informal/deregulated financiers.

Apart from these factors, the attitude of the financial institutions towards lending to the poor has been non-supportive. The banking system was not able to internalise lending to the poor as a viable activity; it did so only as a social obligation something that had to be done because the authorities wanted it so.

This was translated into the banking language of the day: loans to the poor were part of social sector lending and not commercial lending; the poor were not borrowers, they were beneficiaries; poor beneficiaries did not avail of loans - they availed of assistance.

This language resulted in an attitude of carefully disguised cynicism towards the poor. The attitude was that the poor are not bankable, that they can never be bankable, that commercial principles cannot be applied in lending to the poor; what the poor require are not loans but charity. Once this mindset hardened it became more and more difficult for commercial bankers to accept that lending to the poor could be a viable activity. It is significant to note that the system had to wait for almost a decade for the concept of microfinance to become credible.

An Alternative Approach

Given the plethora of research papers available on microfinance and its various aspects, it is difficult to find an altogether new approach of improving efficiency of microfinance models to achieve its stated objective. It is also to be realized that the ground situation varies drastically from place to place; depending upon the spread of financial services in the area and availability of viable option of entrepreneurial activities.

However, an attempt is made here to explore areas where improvements can be made or the process may be redesigned and the guiding principles may be redefined. As we have already discussed the existing models and problems with microfinance in India, we take a fresh look at it by dividing the entire research in areas of Guiding principles of microfinance, Role of Government and NGOs / MFIs and Financial Institutions, delivery channel and effectiveness of assessment methodologies.(Jaiswal,2007)

Guiding Principles of Microfinance:
The following assumptions should form the basic principle of microfinance lending in order to achieve its stated objective:

- Poor are bankable.
- Poor are ready to pay higher than market rate of interest.
- Administrative cost is a major stumbling block for banks in providing the loan to the poor.
- The government subsidy should be channelised to the really needy and viable projects. Poor should be instilled with the spirit of savings.
- Technical knowledge is integral to skill development and viability of any entrepreneurial activity.
- Government role should be that of facilitator rather than of a regulator.
- Model of Self regulatory organisation can be adopted to formulate best practice code.
- Existence of speciality microfinance institutions to provide a focussed approach to the sector.
- Role of Government:
Micro-Finance Industry Failing To Close The Gap

During the past 30 years micro-finance has been proved to be powerful poverty alleviations tool. It is one of the only development tools with the potential to be financially self-sustaining. However after more than 30 years of Industry effort, 80% of the working poor (more than 400 million families) is still without access to microfinance services. At the current growth rates the gap will not be closed for decades. For microfinance to achieve its potential as poverty alleviation tool, the microfinance industry must grow to scale. (Sekhri, 2007)

Conclusion

Microfinance has emerged as a very important paradigm for meeting the credit requirements of poor people, who were until recently outside the coverage of formal banking institutions. But a lack of transparency in the microfinance sector and information asymmetry between microfinance institutions (MFIs) and lenders have made lenders apprehensive of lending to MFIs.

Banking on poor can be a profitable business which has been successfully demonstrated by Grameen Bank, Bangladesh. Deposit mobilization is the major means for MFIs to expand outreach by leveraging equity. In order to be sustainable microfinance lending should be grounded on market principles because large scale lending can’t be accomplished through subsidies.

Microfinance can contribute to solving the problem of inadequate housing and urban services as an integral part of poverty alleviation programmes. The challenge lies in finding the level of flexibility in the credit instruments that can make it match the multiple credit requirements of the low income' borrowers without imposing unbearably high cost of monitoring its end use upon its lenders.

A promising solution is to provide multi-purpose loans or composite credit for income generation, housing improvement, and consumption. Careful research on demand for financing and savings behaviour of the potential borrowers and their participation in determining the mix of multi-purpose loans are essential in making the concept work.

Eventually, it would be ideal to enhance the creditworthiness of the poor and make them more 'bankable' to financial institutions and enable them to qualify for long term credit from the formal sector. MFIs have a lot to contribute to this by building financial discipline and educating the borrowers about repayment.

During the past 30 years micro-finance has been proved to be powerful poverty alleviations tool. It is one of the only development tools with the potential to be financially self-sustaining. Furthermore, certain micro-finance programmes have gained prominence in the development field and beyond. The basic idea of micro-finance is simple, poor people are provided access to financial services including credit, they may well be able to start or expand a micro enterprise that will allow them to breakout of poverty. However after more than 30 years of Industry effort, 80% of the working poor (more than 400 million families) is still without access to micro-finance services. At the current growth rates the gap will not be closed for decades. For micro-finance to achieve its potential as poverty alleviation tool, the micro-finance industry must grow to scale. Poor people have small amounts to save and at frequent intervals. The costs of these transactions are too high. To provide the saving services at a reasonable/affordable rate is still a major concern. Micro insurance to protect the lives, assets, hospitalization expenses and health for poor, effective pension for the aged are some urgently needed products.

Government of India has set up a fund namely Micro-Finance Development and Equity Fund (MFDEF) with a corpus of Rs. 2000 million. The objective of this fund is to promote micro-finance sector in the country including MFIs and their linkages with the banks. Reserve Bank of India, NABARD and the public sector Commercial Banks contribute the fund. The fund is being managed by NABARD.

Recommendations

Micro-Finance sector in India has shown a phenomenal growth in the recent years and led the emergence of two new delivery channel viz. SHG Bank Linkage Model and MFI-Bank Linkage Model has emerged as the largest micro-finance programme in the world. There is an immense scope of
growth of MFIs particularly the under banked areas.

In order to ensure that the poorest benefit from this growth, and also contribute to it, the expansion and improvement of the microfinance sector should be a national priority. In researchers’ opinion, in Bangladesh, where 15 million families now benefit from small loans and other financial products such as micro-savings and micro-insurance, 40% of the overall reduction of rural poverty in recent years has been due to microfinance.

Microfinance is powerful, but it is clearly no panacea. It does not directly address some structural problems facing Indian society and the economy, and it is not yet as efficient as it will be when economies of scale are realized and a more supportive policy environment is created. Loan products are still too inflexible, and savings and insurance services that the poor also need are not widely available due to regulatory barriers. Insufficient data exists on client-level impact, though new tools such as the Poverty Progress Index of Grameen Foundation and the work of Sa-Dhan (the association of Indian MFIs) on measuring client satisfaction are addressing this gap. Still, microfinance is one of the few market-based, scaleable anti-poverty solutions that is in place in India today, and the argument to scale it up to meet the overwhelming need is compelling.

The impressive accomplishments of MFIs and their clients in one state — Andhra Pradesh — provides a glimpse as to what is possible country-wide. In 2000 three leading MFIs — SHARE, SKS and Spandana — reached far fewer than 100,000 families. With support from Sidbi, ICICI Bank, HDFC, Citigroup, Grameen Foundation (and its new joint venture, Grameen Capital India), Friends of Women’s World Banking, Unitus, and others, these three organisations now serve more than 1.5 million families, most of them very poor when they started accessing micro-financial services. SHARE, led by the extraordinary microfinance pioneer Udaia Kumar, alone reaches 900,000. SKS has emerged as the fastest growing microfinance institution in the world and its founder, Vikram Akula, was recently honoured as one of the top 100 people “who shape our world” by Time magazine.

Economies of scale and imaginative uses of technology have brought costs and interest rates down in Andhra Pradesh, as one would expect. The rest of India is catching on and catching up. According to Sa-Dhan, the overall outreach is 6.5 million families and the sector-wide loan portfolio is Rs 2,500 crore. However, this is meeting only 10% of the estimated demand. Importantly, new initiatives are expanding this success story to the some of the country’s poorest regions, such as eastern and central Uttar Pradesh.

A new institutional capacity-building collaboration between American Express Foundation and Grameen Foundation will be critical in ensuring that progress is nationwide and sustainable. Professionally-run, full-service MFIs can and do complement the self-help group movement, which has its own impressive track record. Indian MFIs, through Sa-Dhan, are raising standards, most recently by proposing an industry-wide consumer protection code that most MFIs have already agreed to in principle.

The MFIs should seek out for funds from alternative sources—i.e., equity markets, foreign investors, private equity investors—rather than depending on banks. They should go for such fund sources which offer the lowest cost. And to get funds from such sources they must standardize and improve their practices. In this direction, they should practice full transparency, professional management, disclosures of information on all accounts, implementation of international standardization practices (ISO) and following of Generally Accepted Accounting Principles (GAAP). This will enable them access to institutional funding from across the world who look for such practices before funding.

1. The government must be persuaded to give a proper regulatory mechanism to this industry. This will then help them standardize their activities, at the same time, providing them better acceptance and recognition in the wider financial markets. This means their access to various sources of funds will improve and they would be in a better position to get funds on better terms.

2. The government must also be convinced about the need to provide funds from market to the MFIs directly without involving any other intermediary institutions. This will not only reduce the multiple costs which leads to higher cost of lending by the MFIs but will also enable
investors to think about investing in a commercial project which could enable them better returns. Deposit acceptance, access to capital market, foreign investment, FIIs and One way of bringing down the cost of capital is to create a central organization which could source funds from different parts of the world, as has been done in the case of Sri Lanka (Exhibit 3), which would have very low cost and better terms of credit. This central organization would then channelize that credit to MFIs which will be comparatively very cheap. It will centralize all the efforts to seek funds from different sources by individual MFIs.

3. Information technology is of great help not just to increase efficiency and reduce costs (internal to the organization) but also increase the access and presence of MFI in the global environment (external to the organization). It will add to the acceptance of MFIs across the globe providing better terms in any deal.

4. One way of reducing the operating cost of MFIs could be to employ educated people from rural areas, who are more aware of the ground realities. As their base would be mostly local, they will have incentive to work in the rural areas. Also, this would provide employment opportunities for the rural population and give them opportunities to improve upon their native knowledge through (time-to-time) training provided by the MFIs. Employing traditional 'mahazans' for this purpose as their agents could be another way to benefit from the rural understanding at very low costs.

5. MFIs have to force their sales because they are not entering any new area or are not coming up with any new products which could serve the other needs of the credit seekers at the rural level. This compels them to enter new districts/states/regions on geographical lines or to come up with new innovative products which could address specific needs of the credit seekers. Venturing to provide loans for vocational training, technical education, wedding purposes, etc., could be considered more seriously which could be developed into viable businesses having huge markets. They could also venture into new product areas by offering microinsurance services at the rural level. It will also help to reduce the vulnerability of the underprivileged sections of the society.

6. The local and national governments have an important role to play in ensuring the growth and improvement of microfinance. First and foremost, the market should be left to set interest rates, not the state. Ensuring transparency and full disclosure of rates including fees is something the government should ensure, and something that new technologies as well as reporting and data standards are already enabling.

Furthermore, government regulators should set clear criteria for allowing MFIs to mobilize savings for on-lending to the poor; this would allow for a large measure of financial independence amongst well-managed MFIs — as the Grameen Bank of Bangladesh has achieved in recent years through an aggressive and highly successful savings inititi

Each Indian state could consider forming a multi-party working group to meet with microfinance leaders and have a dialogue with them about how the policy environment could be made more supportive and to clear up misperceptions.

With one state leading the way, we need to build on a successful model. By unleashing the entrepreneurial talent of the poor, we will slowly but surely transform India in ways we can only begin to imagine today.

However even today, the rural credit markets are dominated by moneylenders and some instances of bonded labour have been reported from some parts of the country. Farmers are often bereft of much needed funds for the adoption of modern agricultural practices, tools, fertilizers, insecticides etc. To further conclude Microfinance has enabled the poor to have a greater access to financial services, particularly credit. It has achieved several social development objectives such as gender sensitization, empowerment, and poverty alleviation by diversifying their livelihoods and especially contributed largely towards raising their incomes. It has also allowed the poor to accumulate assets and has contributed towards their security. In areas with sound microfinance programs, the quality of life of the poor has improved significantly.
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