Chapter 3

Microfinance in India
MICROFINANCE IN INDIA

Despite the large size and depth of the Indian financial system, and thousands of bank branches across rural India, the poor in rural India still have very little access to formal finance. A recent World Bank-NCAER Survey on rural access to finance indicates that 70 per cent of the rural poor do not have a bank account and 87 per cent have no access to credit from a formal source. Informal sector lenders remain a strong presence in rural India, delivering finance to the poor on frequently extortionary terms. Access to other financial services such as savings accounts, life, health and crop insurance also remains limited for the rural poor. The failure of India’s rural banks to deliver finance to the poor may be attributed to a combination of factors. From the banks’ perspective, serving the rural poor is a high-risk, high-cost proposition, with high uncertainty, and transactions costs related to small loan size, frequent transactions and government policies which contribute to a financial climate not conducive to rural banking. From the poor rural borrower’s perspective, banks do not provide conveniently accessible and flexible products and services, high transaction costs including cumbersome, costly procedures, hefty bribes, and long processing times and poor borrowers can’t meet the demand for collateral.

Inadequacies in rural access to formal finance and the seemingly extortionary terms of informal finance for the poor provide a strong need and ample space for innovative approaches to serve the financial needs of India’s rural poor. The past decade has witnessed the emergence of many microfinance approaches, most notably, a nationwide attempt, pioneered by non-governmental organizations, and now supported by the state, to create links between commercial banks, NGOs, and informal local groups (“self-help groups,” or SHGs). Better known as “SHG-bank linkage,” evidence suggests that the model has effectively targeted poorer segments of the rural population and helped reduce the vulnerability of its clients. Surveys indicate that nearly 54 per cent of SHG members are from the poorest groups—landless and marginal farmers. Recent analyses show that access for poor households to loans under SHG-bank linkage has improved asset position, increased savings, shifted borrowing patterns and activities financed increased employment and consumption expenditure and had a positive impact on income, decreased poverty and had a beneficial social impact.
It is pertinent to know the basic principle of government credit policy for rural sector particularly for the marginal sections of the society first before jumping into periphery of microfinance. Government credit policies in India for rural sector in particular and rural poor are based on the assumptions that commercial banks are reluctant to advance loans to them due to the risks involved in absence of collateral security and adverse selection. Doubt about the repayment capacity of the poor lead to bankers apprehension about loans becoming non-performing assets (NPAs). Moreover, high transaction costs involved in advancement of these small credits to the customers who are scattered act as a deterrent.

In India, a variety of microfinance schemes and various approaches have been practiced by both government and non-government organisations. There are examples of spectacular success and there are also examples of not-so-successful programs which experienced high default rates and are unable to provide financial assistance in the long run. Ultimately the aim is to empower the poor and encourage them into development.

Variety of microfinance organisations in government as well as in non-government sectors exists in India. Leading national financial institutions like, National Bank For Agriculture and Rural Development (NABARD), the Small Industries Development Bank of India (SIDBI) and the Rastriya Mahila Koshi (RMK) have played a significant role in making microcredit a real movement in India.

In India, microfinance traces its roots to mid-1970s when some prominent Indian NGO like Myrada & Pradan started using the Self-Help Group (SHG) model. The SHG is used as a platform for social mobilization and finance is one of the various services provided to the grass root community through this model. It was widely replicated across other developmental NGOs. It is a community driven and managed microfinance model where the NGO plays the role of a facilitator, for instance providing capacity building services to the groups and building relationships with banks. Microfinance based on Self-Help Groups (SHGs) combines the strengths of Rotational Savings and Credit Associations (ROSCAs) and formal financial institutions. They are similar to ROSCAs in being membership and savings based. They are, however, different from ROSCAs in several ways: their membership is restricted to the poor, they are much smaller (10 to 20 members), and they receive loans from banks to supplement their resources. SHGs are the main suppliers of
microfinance in India. The number of SHGs has been estimated to be over 400,000, with an outreach of nearly six million families; women make up around 90 per cent of the membership.

Amongst Developing countries, India has relatively deep financial system. Its financial depth attributable in large part of India’s vast network of financial institutions; particularly those focussed on rural customers. Since independence, successive governments has emphasised the link between improving access to finance and reducing poverty. The need to improve financial access to India’s poor the overwhelming majority of whom are concentrated in rural areas, motivated the establishment of a vast network of rural co-operative credit banks in the 1950s, followed by a drive to nationalised commercial banks, launched in 1969.

3.1 Formal Financial Sector in India:

While the provision of financial services in India can be traced to the era of Kautilya in the fourth century BC, the age of organized sector finance in India is generally acknowledged to have started with the Cooperative Credit Societies Act of 1904. The Cooperative Credit Societies were based on the models of the German cooperative movement, in particular the Raiffeisen\(^1\). The objective of the Act was to facilitate promotion of cooperative societies, for the promotion of thrift and self-help among agriculturists, artisans and persons of limited means. This Act is a true precursor to modern microfinance in the country. The true expansion of financial services in India started with the Nationalization of all banks in the country during the late 1960s. This was reinforced with the establishment of Regional Rural Banks (RRBs) in 1976, and henceforth directed credit became the mantra of the Indian financial sector. In the meantime, the cooperative sector infrastructure had developed through the creation of an apex banking structure at the District and State levels to ensure the smooth flow of capital in the cooperative system. Yet, the entire network of Primary Cooperatives in the country and the RRBs, established to meet the needs of the rural sector in general and the poor in particular, has not proved to be successful. The cooperatives suffered from mismanagement, leadership by the privileged and corruption, and were gradually smothered by state patronage and protection, in many

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\(^1\) The Raiffeisen credit cooperatives started in Germany by Friedrich Wilhelm Raiffeisen, in 1847, were famously meant to “control the use made of money for economic improvements, and to improve the moral and physical values of people and also, their will to act by themselves”.
cases including management by ill-motivated government-appointed persons. Meanwhile, saddled with the burden of directed credit and a restrictive interest rate regime the financial position of the RRBs deteriorated (Karmakar, 2008). For many years bankers and senior government officers in India described the Government of India’s main poverty alleviation program - the Integrated Rural Development Program (IRDP) - as the world’s largest microfinance program. The objective of IRDP is to enable identified rural poor families to cross the poverty line by providing productive assets. The assets which could be in primary, secondary or tertiary sectors are provided through financial assistance in the form of subsidies by the government and the term credit advanced by financial institutions. The program is implemented in all the blocks in the country as a centrally sponsored scheme funded on 50:50 basis by the centre and state. Started in the early 1980s, the IRDP, involved the commercial banks in giving loans of less than US$330 to poor people and, over twenty years, this resulted in financial assistance of around $5,600 million to roughly 55 million families.

The main problem with IRDP was its design which incorporated a substantial element of subsidy amounting to 25-50 per cent of each family’s proposed investment cost in an income generating activity, prompting extensive misappropriation and misutilization of funds (Dreze 1990; Copestake 1996 & Shankar 1991). This situation led bankers to regard the IRDP loan as a politically motivated hand out and they largely failed to follow up on repayments due from borrowers. The net result was that the estimates of the repayment rates in the IRDP ranged from 25-33 per cent. Not surprisingly, the two decades of IRDP experience in the 1980s and 1990s affected the credibility of micro-borrowers in the view of bankers and ultimately hindered the access of low income clients to banking services (World Bank, 1998).

Home to 1.13 billion people as of 2008, India constitutes approximately one sixth of the world’s total population. It is the world’s largest democracy and a key

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ii The Integrated Rural Development Programme (IRDP) is a rural development program of the Government of India launched in Financial Year 1978 and extended throughout India by 1980. It is a self-employment program intended to raise the income-generation capacity of target groups among the poor.

iii The Scheme is merged with another Scheme named swarnjayanti gram swarozgar yojana (SGSY) since 01.04.1999.

iv A World Bank study (1998) reported few loan recipients acquiring and retaining productive assets and a high percentage of IRDP loan underwatering consumption in case of marriage, sickness and other expenditure.
emerging market alongside China and Brazil. India is amongst the world’s largest economies. All economic indicators viz. GDP growth rate, export growth, foreign exchange reserves, FDI inflows, etc. have shown rising trends during recent years. Although wealth is increasing for the nation but it is not accruing to all citizens.

According to RBI over 40 per cent of India’s poor do not even have bank accounts. The National Sample Survey 59th round (2003) estimates revealed a disappointing fact that of the total cultivator households only 27 per cent have received credit from formal sources and 22 per cent from informal sources. The remaining 51 per cent mostly marginal farmers have virtually no access to credit. According to the new estimates of the World Bank in 2005 around 26 per cent of the world population was living in poverty. The new estimates are based on a new poverty line of $1.25 per day in 2005 Purchasing power parity. Estimates have shown that the share of India increases from 22 per cent in 1990 to 30 per cent in 2005. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution, given the present stage of development of our country (Swain, 2008)\textsuperscript{5}.

Poverty is one of the most important challenges confronting successive governments in independent India. Lots of efforts have been devoted for the elimination of rural poverty. Various anti-poverty programmes have been prepared and implemented for the removal of rural poverty, but all these efforts by the government resulted only in partial success. Various social, cultural and institutional factors are responsible for the vicious circle of poverty which grips the rural masses. Inadequate access to financial services is one of the most important factors behind rural poverty. The role of finance to tackle poverty has been recognized by the government in the early period of independence, which prompted the Government to take a series of steps for making banking system more suitable for rural financing. Despite vast banking network in the country, a sizable section of the population remains outside the domain of the formal banking system. It is widely recognized that access to financial services can play a critical role in helping poor people widen their economic opportunities, increase their asset base and diminish their vulnerability to external shocks. In rural areas, simple financial services like credit and saving can directly affect small scale producers’ productivity, asset formation, income and food security.
Table 3.1 Getting Finance Indicators for India, 2001-08

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>Benchmark (OECD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branches per 1,00,000 people</td>
<td>6.42</td>
<td>6.33</td>
<td>6.25</td>
<td>6.26</td>
<td>6.33</td>
<td>6.37</td>
<td>6.35</td>
<td>6.6</td>
<td>10-69</td>
</tr>
<tr>
<td>ATMs per 1,00,000 people</td>
<td></td>
<td></td>
<td></td>
<td>1.63</td>
<td>1.93</td>
<td>2.4</td>
<td>3.28</td>
<td></td>
<td>47-167</td>
</tr>
<tr>
<td>Deposit accounts per 1000 people</td>
<td>416.77</td>
<td>421</td>
<td>418.7</td>
<td>426.1</td>
<td>432.1</td>
<td>443</td>
<td>459.5</td>
<td>467.4</td>
<td>976-1671</td>
</tr>
<tr>
<td>Loan Accounts per 1000 people</td>
<td>50.99</td>
<td>53.9</td>
<td>55.84</td>
<td>61.88</td>
<td>71.42</td>
<td>78</td>
<td>83.59</td>
<td>89.03</td>
<td>248-513</td>
</tr>
<tr>
<td>Branches per 1000 Km²</td>
<td>22.18</td>
<td>22.3</td>
<td>22.41</td>
<td>22.57</td>
<td>22.59</td>
<td>23.5</td>
<td>24.13</td>
<td>25.49</td>
<td>1-159</td>
</tr>
<tr>
<td>ATMs per 1000 Km²</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5.93</td>
<td>7.11</td>
<td>9.11</td>
<td>12.68</td>
<td>1-437</td>
</tr>
</tbody>
</table>

Source: Getting Finance in South Asia 2010, KaithchaibSophastienphong, Anoma Kulathunga, The World Bank

Note: The Benchmark Indicator ranges are for selected high-income OECD member countries (Australia, Canada, France, Germany, Italy, Japan, The Republic of Korea, New Zealand and the United States)

India has a relatively deep financial system. However, despite an impressive infrastructure including a huge bank branch network, rural areas suffer from a lack of financial services and most poor do not have access to finance. Although the size of India’s financial system in absolute terms doesn’t impress next to other large countries such as China or Brazil, it compares well with other emerging economies (Sonne, 2010).

3.2 Indicator of Access to Formal Finance by the Poor:

Due to the various steps taken by the government to make the banking system more conducive to rural financing, the share of institutional sources in rural financing increased tremendously in 70s. Table 3.2 indicates that the share of all institutional agencies in cash borrowings of rural household was 19.7 per cent during 1971-72.
which increased tremendously to 54.5 per cent during 1981-82, the main driver of this growth were commercial banks. Share of commercial banks was meagre 1.7 per cent during 1971-72 which increased to 23.1 per cent during 1981-82. Hence nationalisation of banks resulted in tremendous achievement as well as rural financing is concerned. The share of institutional agencies in rural credit remains at most constant after 1981-82.

Table 3.2 Percentage Shares of Different Credit Agencies in Cash Borrowings of the Rural Households during 1971-72, 1981-82, 2002-03

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Government etc.</td>
<td>3.1</td>
<td>4.2</td>
<td>3.9</td>
<td>2.7</td>
</tr>
<tr>
<td>Cooperative Societies/bank</td>
<td>14.9</td>
<td>26.3</td>
<td>25.7</td>
<td>28.0</td>
</tr>
<tr>
<td>Commercial banks etc</td>
<td>1.7</td>
<td>23.1</td>
<td>20.7</td>
<td>22.7</td>
</tr>
<tr>
<td>Others(^1)</td>
<td>0</td>
<td>0.9</td>
<td>3.0</td>
<td>3.7</td>
</tr>
<tr>
<td><em>all institutional agencies</em></td>
<td>19.7</td>
<td>54.5</td>
<td>53.3</td>
<td>57.2</td>
</tr>
<tr>
<td>Agricultural money lender</td>
<td>18.7</td>
<td>9.7</td>
<td>8.1</td>
<td>9.6</td>
</tr>
<tr>
<td>Profession money lender</td>
<td>15.9</td>
<td>7.8</td>
<td>13.3</td>
<td>20.6</td>
</tr>
<tr>
<td>Relatives and friends</td>
<td>11.4</td>
<td>12.4</td>
<td>8.9</td>
<td>7.4</td>
</tr>
<tr>
<td>Others(^2)</td>
<td>34.2</td>
<td>14.4</td>
<td>12.1</td>
<td>5.2</td>
</tr>
<tr>
<td><em>all non-institutional agencies</em></td>
<td>80.3</td>
<td>44.3</td>
<td>42.3</td>
<td>42.8</td>
</tr>
<tr>
<td>Unspecified</td>
<td>0</td>
<td>1.2</td>
<td>1.2</td>
<td>0</td>
</tr>
</tbody>
</table>


*Notes:* 1. Includes insurance, provident fund, financial corporation/institution, financial company, and other institutional agencies

2. Includes landlords, traders, doctors and lawyers, etc.

Share of commercial banks retarded over the period 1981-82 to 2002-03. If we compare the figures of the two latest NSSO surveys (1991-92 to 2002-03) then it can be concluded easily that the structural adjustment measures adopted by the government during 90’s are inhibiting the process of financial inclusion. A significant difference exists between different asset holding classes in accessing credit from formal agencies both in rural as well as in urban areas. According to NSSO survey (2002-03) only 18 per cent people have asset holding class less than Rs. 15000 in rural areas are borrowings from formal sources while the corresponding figure for urban areas is 13 per cent. As the asset holding increases the share of formal sources in cash borrowing for both rural as well as urban increases tremendously (Table 3.3)
Table 3.3: Percentage Share of Institutional and Non-Institutional Agencies in Cash Borrowings of Households by Assets Holding Class

<table>
<thead>
<tr>
<th>Assets holding Class (Rs.000)</th>
<th>Rural</th>
<th></th>
<th>Urban</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Institutional</td>
<td>Non</td>
<td>Institutional</td>
<td>Non</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Institutional</td>
<td>Non</td>
</tr>
<tr>
<td>Less than 15</td>
<td>18.0</td>
<td>82.0</td>
<td>13.4</td>
<td>86.6</td>
</tr>
<tr>
<td>15-30</td>
<td>35.5</td>
<td>64.5</td>
<td>40.1</td>
<td>59.9</td>
</tr>
<tr>
<td>30-60</td>
<td>26.6</td>
<td>73.4</td>
<td>46.9</td>
<td>53.1</td>
</tr>
<tr>
<td>60-100</td>
<td>39.5</td>
<td>60.5</td>
<td>59.0</td>
<td>40.8</td>
</tr>
<tr>
<td>100-150</td>
<td>43.6</td>
<td>56.4</td>
<td>65.6</td>
<td>34.4</td>
</tr>
<tr>
<td>150-200</td>
<td>48.1</td>
<td>51.9</td>
<td>47.9</td>
<td>52.1</td>
</tr>
<tr>
<td>200-300</td>
<td>51.5</td>
<td>48.5</td>
<td>71.7</td>
<td>28.3</td>
</tr>
<tr>
<td>300-450</td>
<td>58.7</td>
<td>41.3</td>
<td>72.5</td>
<td>27.5</td>
</tr>
<tr>
<td>450-800</td>
<td>63.4</td>
<td>36.6</td>
<td>84.9</td>
<td>15.1</td>
</tr>
<tr>
<td>800 &amp; above</td>
<td>73.8</td>
<td>26.2</td>
<td>89.8</td>
<td>10.2</td>
</tr>
<tr>
<td>All</td>
<td>57.2</td>
<td>42.8</td>
<td>75.7</td>
<td>24.2</td>
</tr>
</tbody>
</table>


A similar picture is depicted in table 3.4 which shows the incidence of indebtedness to institutional and non-institutional sources of household assets holding class. Only 3.6 per cent households in rural areas of the asset holding class of less than Rs. 15000 are indebted to formal sources, while 85 per cent of households of this asset holding class have no access to any source of credit.

Table 3.4: Incidence of Indebtedness (IOI) of Households by Household Assets Holding Class, 2002
(By end of June)

<table>
<thead>
<tr>
<th>Assets holding Class (Rs.000)</th>
<th>Rural</th>
<th></th>
<th>Urban</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Institutional</td>
<td>Non</td>
<td>Institutional</td>
<td>Non</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Institutional</td>
<td>Non</td>
</tr>
<tr>
<td>Less than 15</td>
<td>3.6</td>
<td>12.0</td>
<td>1.4</td>
<td>9.5</td>
</tr>
<tr>
<td>15-30</td>
<td>6.2</td>
<td>13.9</td>
<td>2.4</td>
<td>12.8</td>
</tr>
<tr>
<td>30-60</td>
<td>8.7</td>
<td>17.7</td>
<td>4.5</td>
<td>11.0</td>
</tr>
<tr>
<td>60-100</td>
<td>10.9</td>
<td>17.7</td>
<td>7.2</td>
<td>11.9</td>
</tr>
<tr>
<td>100-150</td>
<td>13.6</td>
<td>17.9</td>
<td>8.3</td>
<td>12.2</td>
</tr>
<tr>
<td>150-200</td>
<td>14.6</td>
<td>17.1</td>
<td>8.9</td>
<td>12.0</td>
</tr>
<tr>
<td>200-300</td>
<td>16.2</td>
<td>15.7</td>
<td>11.1</td>
<td>10.1</td>
</tr>
<tr>
<td>300-450</td>
<td>18.7</td>
<td>13.2</td>
<td>12.1</td>
<td>8.2</td>
</tr>
<tr>
<td>450-800</td>
<td>22.0</td>
<td>13.0</td>
<td>16.9</td>
<td>7.2</td>
</tr>
<tr>
<td>800 &amp; above</td>
<td>26.7</td>
<td>10.3</td>
<td>18.5</td>
<td>4.2</td>
</tr>
<tr>
<td>All</td>
<td>13.4</td>
<td>15.5</td>
<td>9.3</td>
<td>9.4</td>
</tr>
</tbody>
</table>

The proportion of people having any kind of life insurance cover is as low as 10 per cent and proportion having non-life insurance is an abysmally low at 0.6 per cent. People having debit cards comprises only 13 per cent and those having credit cards only a marginal 2 per cent.\textsuperscript{v}

3.3 Factors behind the Failure of Formal Financial Sector in Serving the Poor:

The failure of India’s rural banks to deliver finance to the poor may be attributed to a combination of factors. From the banks perspective, serving the rural poor is high-risk, high-cost proposition, with high uncertainty, and transaction costs related to small size loan, frequent transactions and government policies which contribute to a financial climate not conducive to rural banking. Commercial banks have their own problems in serving the poor clients such shortage of manpower, unfavourable attitude towards rural services, infrastructure and technology problems in rural areas, etc. (Dev, 2006)\textsuperscript{7}. From the perspective of rural clients, the banks do not provide conveniently accessible and flexible products and services, high transaction costs including cumbersome and costly procedures, hefty bribes, and long processing time and the poor client cannot meet the demand for collateral (Basu, 2006)\textsuperscript{8}. The factors behind the failure of the formal financial sector in serving the poor may be summarized as follows (Wadhwa, 2007)\textsuperscript{9}.

\textbf{a) From the angle of the poor:}

I. Due to their social, economic and educational backwardness and being unorganised, they are unaware of various programs and facilities available from the government and banks and are generally deprived of access to such benefits.

II. They have an apprehension that the banks are not meant for poor people like them and they would not be able to get loans from the banks.

III. Lack of security to avail bank loan.

IV. Documentation procedures, rigid lending policies and norms of the banks generally make the poor ineligible for bank credit.

\textsuperscript{v} According to the lecture delivered by Duvvuri Subbarao, Governor Reserve Bank of India at the Banker’s Club in Kolkata on December 9, 2009
V. Funds requirement for consumption, social and even for production purposes though small are generally emergent. The uncertainty and long delays in obtaining such loans from the banks discourage them to approach the banks.

VI. In some cases, past unpleasant experience of the poor with the banks and government agencies is also a discouraging factor.

b) From the angle of banks:

I. General mental reservation about financing such poor borrowers mainly due to the fear of bad debts.

II. Lack of security to back such loans.

III. Non-compliance of documentation and other formalities by the borrowers.

IV. Non-conformity with the usual banking norms.

V. Low returns to the bank on account of lower rate of interest to be charged on such small loans in accordance with the regulations of the central bank/government.

VI. Serving a large number of small loans with frequent transactions spread over a vast area is unwieldy besides involving high cost, making it convenient and apparently uneconomic for the banks.

3.4 Evolution of Microfinance in India:

In India soon after independence, there has been an aggressive effort on the part of the Government, which was concerned with improving the access of the rural poor to formal credit system. Some of these measures have been institutional, while some others were through implementation of focused programmes for removal of rural poverty. Reaching out of the far-flung rural areas to provide credit and other banking services to the hitherto neglected sections of the society is an unparalleled achievement of the Indian banking system. The main emphasis is the spread of the banking network and introduction of new instruments and credit packages and programmes were to make the financial system responsive to the needs of the weaker sections in the society comprising small and marginal farmers, rural artisans, landless agricultural and non-agricultural labourers and other small borrowers falling below poverty line.

With the implementation of the above policies, further the Government of India in its developmental planning emphasized the promotion of agriculture and
other allied economic activities through credit intervention for ensuring integrated rural development and securing the prosperity of the rural areas. In pursuance of this, formal credit institutions have been guided by the principle of growth with equity and a large share of the credit disbursed for various activities was channelized towards the weaker sections of the society.

Consequently, by the implementation of several poverty alleviation programmes, the number of people below the poverty line has declined from 272.7 million in 1984-85 to 210.8 million in 1989 – 90. In 1991 – 2000 which constitutes over 21 per cent of the population. The number of operational holdings is expected to have crossed the 100 million mark with more than 80 per cent being small and marginal holdings. The institutional credit system needs to meet the challenge of delivering credit to an ever-increasing number of rural people who need greater access to formal credit. It may have to reinforce its own structure at the grass root levels and also have to devise new ways of reaching out to the rural poor.

As a result, the experience of the implementation of the above discussed Poverty Alleviation Programmes led to the introduction of the Integrated Rural Development Programme (IRDP) on 2 October, 1980 with the specific objective of raising the poor rural families above the poverty line. Such families considered credit support from banks as an important input in taking up economic and gainful activities.

In spite of these impressive achievements in the expansion of the credit delivery system and the special programmes, nearly half the indebted rural households are still outside the ambit of the institutional credit system. They approach the moneylenders for meeting their consumption and production in the absence of institutional support. Some of the poor who have not been reached even by the vast network of the institutional credit delivery system, have organized themselves into self-help groups (SHGs) and many such groups have come into existence either spontaneously or with the active involvement of the Voluntary Agencies which motivated the rural poor to pool their meagre financial resources for meeting their small and frequent consumption and production credit needs.

The microfinance sector in India gained real impetus with the establishment of the National Bank for Agriculture and Rural Development (NABARD) in 1982. NABARD's well-known SHG Bank Linkage Programme (SBLP) was initiated
through a pilot in Karnataka and, from the mid-1990s, has now expanded throughout the country. It is increasingly adopted by Government agencies as a vehicle for their programmes. In this model, NABARD refinance commercial bank loans to self-help groups (SHGs) in order to facilitate relationships between the banks and poor borrowers. SBLP has made significant progress since 1998. The bank-SHG linkage programme has greatly increased the outreach of the banking system to otherwise unreached households—especially to women as SHG members and initiated a change in the outlook of banks towards low income families from beneficiaries to customers.

Over the past 30 to 35 years, microfinance was also initiated through the efforts of influential development organizations such as the SEWA Bank (Ahmedabad), Annapurna Mahila Mandal (Mumbai) and Working Women’s Forum (Chennai). This movement began to gain momentum in the 1990s with the entrance of a number of NGOs into microfinance. And since 1995, attempts to reform the cooperative system have also resulted in the creation of a new generation of cooperatives, the “mutually aided cooperatives societies” (MACS) that lie outside the purview of state control. So far, five states have enacted MACS Acts. The new legal system for cooperatives has guarantees of independent management and has resulted in the creation of hundreds of MACS in Andhra Pradesh, for example, many of them directly engaged in microfinance through SHGs of women members.

A complete understanding of the evolution and nature of a country’s financial system, regulation, and government attitude toward the sector is integral to understanding the nature of microfinance in any particular country. Such knowledge allows one to understand what forces shape its growth and what factors constrain it. Understanding the nature of microfinance regulation is especially important to assessing the costs and benefits of transforming from and NGO MFI to an NBFC MFI because regulation outlines the nature of some of those benefits and costs while also providing the legal basis for the different types of legal form a MFI can take.

The World Bank has called South Asia the “cradle of microfinance.” Statistics indicate that some 45 per cent of all the people in the world who use microfinance services are living in South Asia. However, the overall percentage of the poor and vulnerable people with access to financial services remains small, amounting to less than 20 per cent of poor households in India. The World Bank estimates that more than 87 per cent of India’s poor cannot access credit from a formal source and
therefore they are not borrowing at all or have to depend on money-lenders who charge them interest rates ranging from 48 per cent to 120 per cent per annum and sometimes much higher. This demonstrates that there are potential clients for microfinance in India, depending on the level of demand for financial services, from those poor without access to it. The provision of such services, if done correctly, could have a significant impact on the poor. This fact alone is very compelling and is reason enough to occupy oneself with the careful questioning of how microfinance can be provided to as many of the poor with a demand for it as possible. Integral to this questioning is the purpose of this study, understanding the costs and benefits of providing microfinance in the form of a financial company rather than an NGO.

With nearly 400 million people in India below or just below an austere defined poverty line, approximately 75 million households are potential clients of MFIs. Of these, nearly 60 million are in rural India, the remaining 15 million being urban slum dwellers. We are then curious about the penetration of India’s formal financial system thus far in order to understand the depth of outreach. Understanding the depth of the formal financial system is what drives the purpose of considering the benefits and costs to NGOs of becoming NBFCs. How might NGOs and NBFCs approach this market differently? What in their organizational and legal structure positions them better or worse to increase their impact in this market? Understanding the outreach of the formal financial systems provides the necessary information for answering these questions.

In 1999-2000, financial assets in India amounted to about US $430 billion in nominal terms as reported by a 2005 World Bank report, compared to US $250 billion in Argentina and US$386 billion in Mexico. However, India had a lower per capita income in 1999 of U.S. $440 compared to Mexico’s $4,440 and Argentina’s $7,5505 (Basu, Priya(2005)10. With a per capita income in 2004 estimated at US$620, India still ranks among the poorest countries in the Worldvii. Historically, credit to the poor in India was viewed as a government program that required large amounts of subsidy. This has changed somewhat in that the trend has been a move towards more

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commercial forms of financing. This trend has been the product of a long evolution of the financial sector, which can be characterized by three major events.

The first of these pivotal events was Indira Gandhi’s bank nationalization drive launched in 1969 which required commercial banks to open rural branches resulting in a 15.2 per cent increase in rural bank branches in India between 1973 and 1985. Today, India has over 32,000 rural branches of commercial banks and regional rural banks, 14,000 cooperative bank branches, 98,000 primary agricultural credit societies (PACs), and 154,000 postal outlets that are required to focus on deposit mobilization and money transfers. India’s deep financial system is attributable to its vast network of financial institutions. The average population served per commercial bank branch in India in 2002, 15,000 people, compares favourably with other developing countries. Unfortunately, the World Bank indicates that no official survey of rural access to finance has been conducted since 1991 but the World Bank NCAER RFAS-2003 allows for analysis of some trends between 1991 and 2003. Following bank nationalization, the share of banks in rural household debt increased to approximately 61.2 per cent in 1991. Despite these achievements, there still has been little progress in providing the rural poor with access to formal finance. Rural banks serve primarily the needs of richer rural borrowers with some 66 per cent of large farmers having a deposit account and 44 per cent with access to credit in contrast to 70 per cent of marginal/landless farmers that do not have a bank account and 87 per cent that are without access to credit. Access to other financial services such as insurance are even more limited for the rural poor.

The second national policy that has had a significant impact on the evolution of India’s banking and financial system is the Integrated Rural Development Program (IRDP) introduced in 1978 and designed to be ‘a direct instrument for attacking India’s rural poverty.’ This program is interesting to this study because it was a large program whose main thrust was to alleviate poverty through the provision of loans and it was considered a failure. It therefore provides a comparison of what has failed in the past and how this affects the provision of microfinance through private means today. The IRDP was reputed as one of the largest poverty alleviation programs in the world with the number of loans advanced since its inception having reached approximately 45 million Indians with financial assistance worth US$ 6.17 billion disbursed. Despite the massive support for the IRDP however, a government
evaluation in 1989 revealed that it had not achieved the expected results with only 28 per cent of those assisted under the IRDP crossing the poverty line in contrast to private sector-led services and business micro-enterprises which performed better with 33 per cent of those involved in the sector that crossed the poverty line. According to the Indian government, the main factors contributing to the program’s poor performance were loose targeting, bureaucratic delivery systems resulting in high transaction costs, unsuitable financial products ill-suited to the needs of the poor, poor coordination of program support, and political tolerance of loan defaults resulting in extremely poor loan recovery performance. The problem with targeting that the government identified was that the subsidy orientation of the scheme created a huge temptation for the non-poor to participate in the program by dishonest means. There was no effective mechanism for enforcing the selection of the poor clientele based on the official ‘poverty line.’ The means through which the IRDP endeavoured to provide the poor with access to productive assets was credit advanced by commercial banks which the government subsidized. The subsidy provided by the government varied from 25 per cent for small farmers to 50 per cent for scheduled castes and tribal people. The overarching goal of the program was to enhance the income of the rural poor sufficiently so as to enable them to cross the poverty line. Therefore, by this standard the IRDP did not achieve its expected results.

The last major event which impacted the financial and banking system in India was the liberalization of India’s financial system in the 1990s characterized by a series of structural adjustments and financial policy reforms initiated by the Reserve Bank of India (RBI). The result was a partial deregulation of interest rates, increased competition in the banking sector, and new microfinance approaches of which the most notable was a movement to link informal local groups called self-help groups (or SHGs) created by NGOs to commercial banks like the National Bank for Agriculture and Rural Development (NABARD). These financial policy reforms in the 1990s were very significant to microfinance because they involved scrapping the interest rate controls for credit to the poor and other types of credit. These financial liberalization measures then made it possible for NABARD to transform what was then a small research project into a full blown microfinance program for the whole country.
This program was better known as the ‘SHG-bank linkage’ model which has come to be one of the most well-known and widespread microfinance models in India. Since many consider the SHG Bank Linkage model of microfinance to be one of the major successes of microfinance delivery in the country it will provide the most important direct contrast to the delivery of microfinance services by individual MFIs. The number of women’s SHGs linked to banks was reported at 800,000 in 2004 by the World Bank. The rough estimate of women reached was about 12 million. Originally, NABARD provided subsidized refinancing to encourage banks to lend to SHGs, although the demand declined as banks began to discover that SHG lending is quite profitable. Banks would lend to SHGs at about 12 per cent per annum and groups would on-lend to individual members at a rate they determine, typically this would be around 24 per cent per annum. The hypothesis for why individual MFIs not reached as many poor as the SHG Bank Linkage program has been that individual MFIs have been constrained mainly due to lack of resources and capital. Another important point to consider is that the SHG bank linkage model is dependent on the formation of SHGs, something that in India has been done by NGOs and therefore requires subsidy. This provides a helpful separation of activities that require subsidy, the creation of SHGs, and those that can operate on a commercial basis such as bank lending to those SHGs.

In line with worldwide trends, microfinance in India emerged as an effort to reach out to the un-banked, lower income segments of the population. Most microfinance initiatives were a response to the “white spaces” left by the relatively widespread banking infrastructure in the country.

After 1990, India witnessed the second phase of initiatives in rural credit delivery. These mirrored other initiatives across the globe in the 1980s that operated on certain common principles such as the reliance on peer pressure as opposed to physical collateral, self-sustainability, and self-help. It is during this period that “microfinance,” as it is understood today, first emerged on the Indian development scene. NABARD initiated the Self Help Group (SHG) - Bank Linkage program, which links informal women’s groups to formal banks. This concept held great appeal for non-government organizations (NGOs) working with the poor, prompting many of them to collaborate with NABARD in the program.
Such initiatives then led to the development of a new paradigm for what is now known as “commercial microfinance” or the “financial system approach.” This period was marked by the extension of credit at market rates, unlike the focus on subsidies during the social banking phase. This period also witnessed the entry of another set of stakeholders Microfinance Institutions (MFIs), largely of non-profit origins, with existing development programs. Financial intermediation emerged as the new development mantra for engaging with the poor. They were supported in this effort by apex institutions such as SIDBI, Rashtriya Mahila Kosh (RMK) and Friends of Women's World Banking (FWWB)\textsuperscript{viii} through extension of on-lending funds. Though initially aided by international donors and soft loans, many of the NGO-MFIs went on to access commercial loan funds from domestic banks and achieved extensive client outreach.

Indian public policy for rural finance from 1950s to till date mirrors the patterns observed worldwide. Increasing access to credit for the poor has always remained at the core of Indian planning in fight against poverty. The assumption behind expanding outreach of financial services, mainly credit was that the welfare costs of exclusion from the banking sector, especially for rural poor are very high. Starting late 1960s, India was home to one of largest state intervention in rural credit market and has been euphemistically referred to as 'Social banking' phase. It saw nationalisation of existing private commercial banks, massive expansion of branch network in rural areas, mandatory directed credit to priority sectors of the economy, subsidised rates of interest and creation of a new set of rural banks at district level and an Apex bank for Agriculture and Rural Development (NABARD) at national level. These measures resulted in impressive gains in rural outreach and volume of credit. As a result, between 1961 and 2000 the average population per bank branch fell tenfold from about 140 thousand to 14000 (Burgess & Pande, 2005)\textsuperscript{11} and the share of institutional agencies in rural credit increased from 7.3 per cent 1951 to 66 per cent in 1991.

These impressive gains were not without a cost. Government interventions through directed credit, state owned Rural Financial Institutions (RFI) and subsidised interest rates increased the tolerance for loan defaults, loan waivers and lax appraisal

\textsuperscript{viii} Set up in 1982, FWWB is a non-profit organization and an affiliate of Women's World Banking. More information available at: http://fwwbindia.org/site/index.html and http://www.swwb.org/.
and monitoring of loans. The problem at the start of 1990s looked twofold, the institutional structure was neither profitable in rural lending nor serving the needs of the poorest. In short, it had created a structure, ‘quantitatively impressive but qualitatively weak’.

Microcredit emergence in India has to be seen in this backdrop for a better appreciation of current paradigm. Successful microfinance interventions across the world especially in Asia and in parts of India by NGOs provided further impetus. In this backdrop, NABARD’s search for alternative models of reaching the rural poor brought the existence of informal groups of poor to the fore. It was realised that the poor tended to come together in a variety of informal ways for pooling their savings and dispensing small and unsecured loans at varying costs to group members on the basis of need. This concept of Self-help was discovered by social-development NGOs in 1980s. Realising that the only constraining factor in unleashing the potential of these groups was meagreness of their financial resources, NABARD designed the concept of linking these groups with banks to overcome the financial constraint. The programme has come a long way since 1992 passing through stages of pilot (1992-1995), mainstreaming (1995-1998) and expansion phase (1998 onwards) and emerged as the world’s biggest microfinance programme in terms of outreach, covering 1.6 million groups as on March, 2005. It occupies a pre-eminent position in the sector accounting for nearly 80 per cent market share in India.

Under the programme, popularly known as SHG-bank linkage programme there are broadly three models of credit linkage of SHGs with banks. However, the underlying design feature in all remains the same i.e. identification, formation and nurturing of groups either by NGOs/other development agencies or banks, handholding and initial period of inculcating habit of thrift followed by collateral free credit from bank in proportion to the group’s savings. In accordance with the flexible approach, the decision to borrow, internal lending and rate of interest are left at the discretion of group members. Its design is built on combining the “collective wisdom of the poor, the organizational capabilities of the social intermediary and the financial strength of the Banks”

Between 1973 and 1985, bank branches in rural areas grew at an average of 15.2 per cent each year, about double the growth rate of branches in semi-urban (6.4 per cent), urban (7.8 per cent) and metropolitan (7.5 per cent) areas. Rural branches
grew from 1,833 in 1969 to 30,186 in 1985, an increase of 1,547 per cent. By
comparison, the increase over the same period for semi-urban, urban and metropolitan
areas was only 1, 94,315 and 220 per cent. Today, India has over 32,000 rural
branches of commercial banks and regional rural banks (RRBs), some 14,000
cooperative bank branches, 98,000 primary agricultural credit societies, not to speak
of the thousands of mutual fund sellers, several non-bank finance companies (NBFCs)
and a large post office network with 1,54,000 outlets that are required to focus on
deposit mobilisation and money transfers. The strategy during much of this period
gave the lead role to the nationalised commercial banks, which were charged with
loosening the grip of traditional informal sector moneylenders through the use of
targeted low-priced loans (Reddy 1999)\textsuperscript{12}.

Within this policy context, the development of India’s financial sector
inevitably resulted in substantial achievements in enhancing access to credit in rural
areas; indeed, rural access was also an important metric in assessing the growth of the
financial sector in the country. Shortly after independence in 1947, the first survey of
rural indebtedness (All India Rural Credit Survey, or AIDIS) prepared by the Reserve
Bank of India (RBI) documented that moneylenders and other informal lenders met
more than 90 per cent of rural credit needs. The share of banks in particular was only
about 1 per cent in total rural household debt. This ratio remained low until 1971
when it was 2.4 per cent, although the share of formal sources of credit in rural areas
increased steadily to 29 per cent due to the rising share of cooperatives. Following
bank nationalisation, the share of banks in rural household debt increased to about 29
per cent in 1981 and 1991 while the share of formal or institutional sources in total
debt reached 61.2 per cent before declining in 1991. Correspondingly, the share of
moneylenders apparently declined steadily over these four decades, from 69 per cent
in 1951 to less than 16 per cent in 1991.

3.5 Need for Microfinance:

Microfinance aims at assisting communities of the economically excluded to
achieve greater levels of asset creation and income security at the household and
community level. Access to financial services and the subsequent transfer of financial
resources to poor women enable them to become economic agents of change. Women
become economically self-reliant, contribute directly to the well-being of their
families, play a more active role in decision making and are able to confront
systematic gender inequalities. Access to credit has been given considered a major poverty alleviation strategy in India. Micro-credit has given women in India an opportunity to become agents of change. Poor women, who are in the forefront micro-credit movement in the country use small loans to jump, start a long chain of economic activity.

Microfinance is accessing financial services in an informally formal route, in a flexible, responsive and sensitive manner which otherwise would not have been possible for the formal system for providing such services because of factors like high transaction cost emanating from the low scale of operation, high turnover of clients; frequency of transaction etc. Microfinance and self-help group must be evolved to see that SHGs do not charge high rates of interest from their clients and improve access to those who cannot sign by their use through thumb impression.

The current literature on microfinance is also dominated by the positive linkages between microfinance and achievement of millennium development goals (MDGs). Micro-credit Summit Campaign's 2005 report argues that the campaign offers much needed hope for achieving the millennium development goals especially relating to poverty reduction. IFAD along with food and agriculture organization (FAO) and the world food programme (WFP) declared that it will be possible to achieve the eight MDGs by the establishing deadline of 2015 "if the developing and industrialized countries take action immediately by implementing plans and projects, in which micro-credit could play a major role.

Credit is vital to the poor for overcoming the inevitable and common imbalance between income and expenditure. Credit is also crucial to the poor for income generating activities, like investing in their marginal farms or other small scale self-employment ventures. Their access to formal banking channels, however, is limited due to their low resource bases as well as due to the nature of formal credit institutions. The popularity of the microfinance, self-help groups stems from widespread recognition that formal banking channels are largely ineffective in catering to the credit needs of the poor.

Tiny savings and loans are generally an unattractive business proposition for formal banking institutions. In addition to disincentives faced by the banks, there are also problem faced by the poor in accessing loans from formal banking institutions.
For example, to minimize risks, banks demand, collateral security that the average micro borrower does not possess. Banks also insist on complicated procedures that are too time consuming and often too complicated for the poor and illiterate. Even in the implementation of direct lending programmes formal institutions find it difficult to overcome the problem of targeting. The experience is that the rich and powerful typically manage to corner the scare loanable funds. Thus formal banking channels remain largely inaccessible to the poor in India. As a result, the poor continue to be dependent on informal sector lending, paying exorbitant rates or underselling the product and their labour power to the creditor. It was in response to these limitations in formal banking channels that micro credit mechanisms were innovated.

In the Indian context, especially in rural areas, there remains a vast lacuna in the availability of formal finance, and informal finance often comes tagged with extortionary terms or conditions of servitude. Following the bank nationalization drive started by Indira Gandhi in 1969, where commercial banks were required to open rural branches, India’s banking network grew exponentially. Today India boasts of over 32,000 rural branches of commercial banks and regional rural banks, around 14,000 cooperative bank branches, 98,000 primary agricultural credit societies, 154,000 outlets of the post office network, as well as several other non-bank finance companies and mutual fund sellers. While the numbers seem impressive, it has been estimated that 70 per cent of the marginal and landless farmers do not have a bank account and 87 per cent have no access to credit from a formal source, leading to the conclusion that rural banks primarily serve the interests of the richer rural populace. From among the households surveyed under the RFAS-2003 (Rural Finance Access Survey 2003), over 90 per cent reported that they funded unexpected expenses from cash at home, and the second most significant source was informal borrowing from friends, relatives and moneylenders. These statistics gave microfinance a vast playing-field, and taking heed of this potential, the industry has grown to serve over 70 million clients in India alone.

### 3.6 Microfinance and Sustainable Livelihoods:

A livelihood comprises the capabilities, assets (including both materials and social resources) and activities required for a means of living. A livelihood is sustainable when it can cope with and recover from stresses and shocks maintain or enhance its capabilities and assets, while not undermining the natural resource base.
Livelihood framework enables a better appreciation of the context and possibilities of development interventions, including microfinance at different levels. After decades of limited success in eliminating rural poverty, new ideas about rural development are emerging. A number of prominent agencies are currently revising their rural development strategies in broadly similar directions.

The so-called ‘livelihoods approaches’ work with people, supporting them to build upon their own strengths and realize their potential, while at the same time acknowledging the effects of policies and institutions, external shocks and trends. The aim is to do away with pre-conceptions about what exactly rural people are seeking and how they are most likely to achieve their goals, and to develop an accurate and dynamic picture of them in their environment. This provides the basis for identifying the constraints to livelihood development and poverty reduction. Such constraints can lie at local level or in the broader economic and policy environment. They may relate to the agriculture sector or they may be more to do with social conditions, health, education or rural infrastructure Sa-Dhan (2005)^13.

The key strengths of the livelihoods approach are as follows:

- It projects the far truer picture of rural life and rural poverty, thus making way for better targeted poverty reducing interventions. Recent studies have revealed that most rural households rely on multiple income sources and adopt the range of survival strategies (including various types of migration and straddling, whereby some members stay in rural areas while others live in semi permanently in urban areas).
- They recognise the importance of multiple actors (from the private sectors to the national level ministries, from communities based organisations to the new decentralised government bodies), thereby widening the range of potential partners.
- They make serious efforts to understand the national and international linkages and the effect these have on people’s livelihoods. In the past, the physical isolation of rural areas has led to the view that these linkages had little relevance.
- They emphasise the multi-faceted notion of sustainability. In rural areas sustainability is often associated with natural resources, which are clearly important but not the only aspect of sustainability which is important.
Livelihoods approaches have learnt from participatory assessments that vulnerability is a core dimension of poverty. Reducing vulnerability—helping people develop resilience to external shocks and increase the overall sustainability of their livelihoods—is therefore a priority.

The Institute of Development Studies (IDS) Sussex has been at the forefront of the conceptualisation of the livelihoods approach. The IDS sustainable rural livelihoods framework has a number of basic elements. The framework can be applied to a range of different scales—from individuals, to household cluster, to extended kin grouping, to village region or even nation, with sustainable livelihoods outcomes at different levels. The specification of the scale of analysis is therefore critical, as is an analysis of the interactions between levels in terms of net livelihoods effects, both positive and negative.

3.6.1 Livelihood Strategies: Portfolios and Pathways:

Within the sustainable livelihoods framework, three broad clusters of livelihood strategies are identified, these are

- Agricultural intensification/Extension
- Livelihood diversification
- Migration

Broadly these are seen to cover the range of options open to rural people. Either you gain more of your livelihood from agriculture (including livestock rearing, aquaculture, forestry etc) though processes of intensification (more output per unit area through capital investment or increases in labour (inputs) or extensification (more land under cultivation), or you diversify to a range of off farm income-earning activities, or you move away and seek a livelihood, either temporarily or permanently, elsewhere.

**Agricultural intensification/extensification**—between capital-led (supported often by external inputs and policy led) and labour-led (based on own labour and social resources and a more autonomous process) intensification.

**Livelihood diversification**—between an active choice to invest in diversification for accumulation and reinvestment, and diversification aimed at coping with temporary adversity and more permanent adaptation of livelihood activities, when other options...
are failing to provide a livelihood. Diversification therefore, may involve developing a wide income earning portfolio to cover all types of shocks or stress jointly or the strategy may involve focusing on developing a response to handle a particular type common shock or stress through well-developed coping mechanisms.

Migration- between different causes of migration (e.g. Voluntary and involuntary movement), effects (e.g. reinvestment in agriculture, enterprise and consumption at the home or migration site) and movement patterns (e.g. to or from different places).

3.6.2 Sustainable Livelihood: A Microfinance Perspective:

The livelihood approach of microfinance institutions (MFIs) is prima-facie to full fill its objective to support poor people by providing credit and building livelihood opportunities. In a long term perspective, this is what provided for the sustainability of the microfinance sector. More over the shift I the loan requirement from consumption to production purposes ultimately delivers overall economic development. The poor need credit, but credit with a package of other services such as financial and skill development services to move into microenterprise and develop the microenterprise activities, which are critical elements for eradicating poverty.

Also, for some of the MFIs sustainable livelihoods approach is the result of the strategy shift for scaling up. If an MFI continues to be limited to financial operations and not extended to microenterprise activities, after a point, growth will be a real problem. This has been experienced by the Grameen Bank in Bangladesh and, since 2000s onwards, they offer microenterprise services as well. This helps an MFI in two ways (i) ensures the sustainability of microfinance activities; and (ii) ensure poverty reduction by providing employment and income to clients. Where as many of the Indian MFIs approach the clients from the beginning with a clear project on the livelihood development, which could be the reason for a totally different categorical growth that Indian MFI achieved, over the years. The Millennium Development Goals declared by the United Nations to remove poverty should also serve to accelerate the introduction of livelihoods approach to microfinance.
3.7 Microfinance Delivery Models:

India has been a fertile breeding ground for a large number of models of microfinance, each of which becomes hugely popular. In fact it can be said that India hosts the maximum number of microfinance models, both in indigenous practices as well as in modern microfinance. The sheer geographical size of the country, a wide range of social and cultural groups, the large spectrum of economic classes and a very active non-governmental organisation (NGO) movement can be said to have
contributed towards the emergence of such a diverse microfinance models. The models range from pure ‘home-spun’ verities like the SHGs and the co-operatives to the ‘adapted’ models like the Grameen methodology and for profit corporate models, (Sa-Dhan, 2005)\textsuperscript{14}.

In a dynamic field of microfinance, there is clearly no one best way to deliver services to the poor- multiple models exist and each has succeeded in its respective context. There could be many more alternative technologies that have been successful in providing microfinance services to the poor.

Delivery models can be divided into two broad categories.

I) Group Models:

The group approach delegates the entire financial process to the group rather than to the financial institutions. All financial activities like savings, getting loans, repayment of loans and record keeping are managed at the group level. In this method, 10-20 members are organised to form a group. These group members make regular savings of fixed amount in a common fund. The amount and frequency of savings is mutually decided by the group members. After the successful working of such a group for some months the group is linked to a financial institution for getting credit. The financial institutions issue loan in the name of group and whole group is considered responsible for repayment. The amount of loan depends upon the total accumulated amount of saving of the group. Group members themselves decide about the criteria of dividing the loan among the group members. With this loan the whole group may jointly start a microenterprise or the members may start their individual businesses. An individual may also use his loan for consumptive purpose or meeting other priority needs. The peer pressure in the group helps the timely repayment of loan. These type of group based credit delivery methods help to empower the group members because they remain involved in various group activities. They visit the bank, market and hold group meetings which help them to increase self-confidence. In India, the group based credit delivery method known as SHG-BLP is a predominant method of providing microfinance. Programme Hubungan Bank Danksm (PHBK) project in Indonesia and the Chikola groups of K-REP in Kenya are also using such group based credit delivery models.
II) Individual Models:

In this method, individuals can get loans without any membership of a group. This is a straightforward credit lending model in which micro-loans are given directly to the borrowers. In this model, the financial institutions have to make frequent and close contact with individual clients to provide credit products customised to the specific needs of the individual. It is most successful for larger, urban-based, production-oriented businesses. The model is followed by many financial institutions like the Association for the Development of Micro-Enterprises (ADEMI) in Dominican Republic, Bank Rakyat Indonesia, Senegal Egypt, Self-Employment Women’s Association in India, etc.

Group models can be divided into different categories:

I) Self-help Groups (SHG)- Bank-linkage
II) Microfinance Institutions Model
III) The Grameen Bank Model
IV) Joint Liability Groups (JLG)
V) The Co-operative Model

The individual model corresponds to individual banking: As of March 2009, over 1.716 million Self-help Groups (SHGs) active in India represented over 54 million microfinance clients, while the MFI model, growing at a staggering 60 per cent per annum, served another 22.6 million.

I) Self-help Group-Bank-linkage Model (SHG Model):

The SHG model, in the form of the SHG-Bank-linkage program (SBPL) was initiated in the early 1990s by the National Bank for Agriculture and Rural Development (NABARD). SHG linkage is based on the principle of ‘savings first’. These savings are not only a way of creating group solidarity and, testing people’s willingness regularly to keep some cash aside, they also create a loan fund from which the group can borrow. Such groups normally comprise of 15-20 women. Peer-pressure replaces traditional guarantees, such as references and assets or collateral. The existing network of government banks binds the SHGs to credit channels, and having demonstrated the financial success of this endeavour. The private banks are also increasingly venturing into this field.
To obtain loans from banks, the SHG members must first establish their credit-worthiness, by maintaining scrupulous records of savings and mutual lending, usually for a period of six months. Further, the mechanism guards against defaults on loan payments, as no new member may receive a fresh loan until the previous arrears are cleared. Another repayment incentive is the ability to access larger repeat loans upon on-time repayment. The loans offered to the SHGs are usually a multiple (2-4 times) of their savings, and are granted to the SHG as a whole, which then decides autonomously on the disbursement among the members. It is argued that the meetings reinforce a culture of discipline, routine payments and staff accountability, while others counter the claim arguing that daily or weekly congregation compounds the workload of the borrowers and at times discourages new entrants. There is also the assertion that the ‘group leader’ may wield undue control over loans issued to the other members.

While ideally, once members have managed to build up their assets, they should be able to operate individual accounts; this is not always the case. Critics of the SHG movement argue that poor people, given the choice, prefer an individual service and the simplicity of a reliable retailer managing the bookkeeping, rather than taking on the added responsibilities and risks of running their own mini-financial institution (SHG).

Among the other drawbacks, SHGs entail a process of mutual self-selection, which may lead to the exclusion of the economically weakest members in a community. Further, it is noted that repayment does not depend solely on peer pressure; rather it also requires management, transparency and accountability, for which apparatus of training and supervision should be in place.

II) Microfinance Institutions Model:

This second model of microfinance in India is mainly a private sector initiative. Semi-formal institutions that undertake microfinance services as their main activity are referred as microfinance institutions (MFIs). MFIs are an extremely heterogeneous group comprising Non-Banking Finance Companies (NBFC), Societies, Trusts and Cooperatives. They are provided financial support from external donors and apex institutions including the Rashtriya Mahila Kosh (RMK), SIDBI Foundation for Micro Credit and NABARD and employ a variety of ways for credit
delivery (Batra, & Sumanjeet 2011). Task Force on Supportive Policy and Regulatory Framework for microfinance (1998) setup by NABARD define MFIs as:

"Microfinance institutions (MFIs) are those which provide thrift, credit and other financial services and products of very small amounts mainly to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards".

III) The Grameen Model:

The Grameen model was initiated by Mohd. Yunus in Bangladesh. With this model, the institution lends to affinity groups of 5 individuals. These groups are very standardized in structure. They organize weekly meetings and saving is mandatory for members. Credit is not given to all members simultaneously, but all hope to have their turn and all stand for each other’s obligations. The groups are created under supervision of the MFI, according to a well-defined structure to facilitate access to microfinance services.

IV) Joint Liability Groups or Individual Liability:

MFIs serve as ‘lending intermediaries’ between investors (banks/private equity firms) and the microcredit borrowers. In India, they exist either as NGOs or as Non-Banking Finance Companies (NBFCs). The Joint Liability Group method was made famous by Grameen Bank in Bangladesh and has been replicated by MFIs across the world.

Under the JLG model, MFIs organize members into groups with the understanding that even though members will be given individual loans, the group as a whole will be liable for repayment. As in the case of the SHGs, social pressure ensures that repayment levels remains over 98 per cent in India. The size of the group is much smaller than an SHG with each group comprising of 5 women. Certain MFIs also lend to individuals with individual liability. In order to qualify for a bigger individual loan, members must have demonstrated good credit history over one to two years.

The advantage of the JLG model over the SHG model lies in the former’s ability to scale. It is highly replicable and allows MFIs to rapidly expand their client base and become more profitable. In fact, 30 per cent of the 70 million microfinance clients in India are members of the top 10 MFIs. Critics of the MFI/JLG model argue
that high growth rate experienced by MFIs in India has translated into a mission drift with the focus shifting from client satisfaction to profit making.

V) The Co-operative Model:

This has been initiated by Cooperative Development Forum, Hyderabad which has relied upon a 'credit union' involving the saving first strategy. It has built up a network of Women Thrift Groups (WTGs) and Men Thrift Groups (MTGs). They are registered under Mutually Aided Cooperated Society Act (MACs) and mobilize savings resources from the members and access outside-supplementary resources from the individual system.

3.8 Prospects of Microfinance:

Microfinance programme has witnessed phenomenal growth in India in the past years. Studies show that this programme is helping the poor in many ways. However, the focus of most of the microfinance service providers has remained on expanding the outreach of microfinance programme with little attention on the depth, quality and viability of the financial services. Besides removing these problems there is a lot which can be done in this field to make this programme more effective. Some future prospects in this field are discussed below:

3.8.1 Growth Prospects:

Microfinance programme has a wider prospect to expand both the outreach and depth of services provided. According to Ghate (2008)\textsuperscript{16}, microfinance programme has covered just 16.5 million of the total 75 million poor households. So, there is an ample scope to cover these unreached poor people. Also, the average loans provided to the SHG members under both the SHG-BLM and MFI models range between Rs. 3,500 to 5,000 which can meet the liquidity requirements only and are not sufficient to help a member to start productive activities. So far the government has been succeeded in providing only Rs. 2,000 crore annually against a demand of over Rs. 50,000 crore by the 75 million poor households (Ghate, 2007)\textsuperscript{17}. Hence, there is a vast unmet demand in the rural and urban sectors, and there is ample scope for the growth of different kinds of MFIs and microfinance service providers. In order to expand the microfinance programme, SHGs may be linked with the post offices for disbursement of credit to rural poor by utilising the vast network of post offices in rural areas. NABARD has launched a pilot project of this type in Tamil Nadu.
I) Reducing Regional Disparity:

The spread of microfinance programme is unequal among various regions of India and there is limited spread in the poorer states. So, there is ample scope to spread microfinance programme in the unreached areas including the poorer states. However, taking a step in this direction NABARD has recently identified 13 states to scale up the microfinance programme in these states in order to reduce the regional disparity. These priority states are Assam, Bihar, Jharkhand, Gujarat, Himachal Pradesh, Maharashtra, Madhya Pradesh, Chhattisgarh, Orissa, Rajasthan, Uttar Pradesh, Uttarakhand and West Bengal. These states accounted for 70 per cent of India's poor and were not effectively reached by the microfinance programme. Special efforts by NABARD resulted in an increase in the number of SHGs credit linked in these states from 3,97,464 as on March 2004 to 17,64,856 as on March 2008. The growth rate in these states is higher as compared to the growth at national level but it is not increasing as compared to the previous years. Therefore some other measures can be taken to eradicate the regional disparities in the coming future.

**Figure 3.2: SHG Coverage in India**

*Source: Status of Microfinance 2012-13, NABARD*
3.8.1 Inclusive Growth: Meaning and Challenges:

The banking industry has shown tremendous growth in volume and complexity during the last few decades. Despite making significant improvements in the areas relating to financial viability, profitability and competitiveness, there are concerns that banks have not been able to include vast segments of the population, especially the underprivileged sections of the society, into fold of basic banking services (Thorat, 2007a). So, this lead to the emergence of Financial Inclusion as a strategy to bring so called excluded population in to the mainstream. Financial inclusion is the delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public the policy. Although credit is the most important component, financial inclusion covers various financial services such as saving insurance, payments and remittance facilities by the formal financial system to those who tend to excluded (Mahendra S, 2006).

In India, the drive for financial inclusion, initiated by the Reserve Bank of India, has thus far involved ensuring access to at least one zero minimum- balance ‘no frills’ savings bank account to every households. In this context, at least one district in each state has been brought under the purview of this drive with public sector banks in the region taking the lead to open at least one bank account per family in the districts.

The broad objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty.

Inclusive growth encompasses ideas related to basic needs and equity. It focuses on broad-based growth so that growth covers all strata of society. It seeks to bridge the various divides that may fragment the society. Reduction in poverty and disparities of income and ensuring everyone a basic minimum standard of living are the objectives of inclusive growth. In this context access to finance by the poor and vulnerable groups has to be recognized as a pre requisite for poverty reduction and social cohesion. It has to become an integral part of the efforts to promote inclusive
growth. In fact, providing access to finance is a form of empowerment of the vulnerable groups.

3.8.2 Focus on Women Empowerment:

Empowerment is a process of awareness and capacity building leading to greater participation and better decision making power and transformative action. Department for International Development (DFID) defined women empowerment as "Individuals acquiring the power and act freely, exercise choice, and to fulfil their potential has fallen equally members of society". Microfinance is one of the unique modes of finance to the marginal and vulnerable section of society. Around 100 crore people who have no access to formal financial services in the world and a large chunk of population lives in India. Development of local resource based economy will provide additional employment and income to people living in poverty both in urban and rural areas. Microfinance holds up good position to help socially backward and economically weaker section of society.

In Indian society, women constitute a sizable section of rural work force. The realization of women's full potential is crucial to the overall socio-economic development and growth of a society. In spite of this Indian society is still predominant by male section of the society. However this realization will require a real revolution that will place gender at the heart of policy making and planning in all areas of development and that will awaken the full awareness among the people.

Finance is the most important component of any economic activity. The main objective of rural finance is to provide loans at concessional rate through administrative control targeting the rural people specially the women and those who are engaged in agriculture and non-agricultural activities. But it is felt that a large number of poverty stricken people and particularly the women who constitute a significant number still remain outside the ambit of institutional finance.

Further, experience in many countries demonstrates that poor women make investments wisely and earn returns. However the flow of financial assistance to them was too marginal, if at all, to enable them to cross the poverty line. The need to create a grassroots, organizational base to enable women to come together, to analyse their issues and problems themselves, and to fulfil their need was strongly advocated. In fact, experience shows that some of the successful group based particularly
programmes have made significant improvement in the living condition of the poor women. The concept of self-help groups gained significance, especially after 1976 when Prof. Yunus of Bangladesh began experimenting with micro credit and women SHGs.

Before 1990s, credit schemes exclusively for rural women as target groups were almost negligible. The concept of women’s credit was born on the insistence by women oriented studies that highlighted the discrimination against, struggle of women in having access to credit. However, there is a perceptible gap in financing genuine credit needs of the poor, especially woman in the rural sector. Behind this persistent gap lies certain unfounded assumption. In India there are certain misconceptions about the poor people that they need loan at subsidized rates of interest on soft terms, they lack education, skills, capacity to save, credit worthiness and therefore are not bankable. Nevertheless, the experiences of several SHGs reveal that rural poor actually efficient managers of credit and finance. Availability of timely and adequate credit is essential for them to undertake any economic activity rather than credit subsidy. In other words quality of credit is important along with its quantity.

In India, the trickle down effects of macroeconomic policies have failed to resolve the problem of gender inequality. Women have been the vulnerable section of society and constitute a sizeable segment of the poverty-struck population. Women face gender specific barriers to access education health, employment etc. Micro finance deals with women below the poverty line. Micro loans are available solely and entirely to this target group of women. There are several reasons for this among the poor, the poor women are most disadvantaged—they are characterized by lack of education and access of resources, both of which is required to help them work their way out of poverty and for upward economic and social mobility. The problem is more acute for women in countries like India, despite the fact that women’s labour makes a critical contribution to the economy. This is due to the low social status and lack of access to key resources. Evidence shows that groups of women are better customers than men, the better managers of resources. If loans are routed through women benefits of loans are spread wider among the household.

Since women's empowerment is the key to socio-economic development of the community; bringing women into the mainstream of national development has
been a major concern of the government. The Ministry of Rural Development has special components for women in its programmes. Funds are earmarked as “Women’s component” to ensure flow of adequate resources for the same. Besides Swarnagayanti Gramin Swarazgar Yojana (SGSY), Ministry of Rural Development is implementing other scheme having women’s component. They are the Indira Awas Yojana (IAY), National Social Assistance Programme (NSAP), Restructured Rural Sanitation Programme, Accelerated Rural Water Supply Programme (ARWSP) the (erstwhile) Integrated Rural Development Programme (IRDP), the (erstwhile) Development of Women and Children in Rural Areas (DWCRA) and the Jowahar Rozgar Yojana (JRY).

3.8.3 Gender Dimension in Economic Development:

In the given context, what are particularly interesting are the differences between institutional economics and mainstream neo-classical economics in terms of their conceptualization of driving forces behind human development. While neoclassical economics considers human behaviour mainly to be the result of free human agency, institutional economics offers more credibility to the independent influence of norms and institutions, of course without swinging the pendulum too far in the other direction. Institutional economics treats norms, preferences and values as partially endogenous, and asks how they evolve. Besides it takes collective action seriously, asking how people may come to identify with, and pursue common interests within social groups and it provides insight into the ‘autonomous’ influence on human behaviour of a socio-cultural construct such as ‘gender’ whose manifestation clearly varies over time and space. Authors such as Agarwal (1994)\textsuperscript{20}, Folbre (1995)\textsuperscript{21}, and Kabeer (1994)\textsuperscript{22} argue that ‘gender’, similarly to other norms and rules, defines the realm of choice. In making human behaviour predictable, ‘gender’ is believed to reduce the transaction/coordination costs involved in human interaction. For instance, the mere fact that ‘gender’ determines, to varying degrees, which tasks men and women ‘are supposed to perform’ reduces the time individual men and women need to spend on day-to-day bargaining over time and task allocation.

Quite a good strand of empirical and theoretical literature (to cite a few: Thomas, (1990)\textsuperscript{23}; Haddad, Hoddinott and Alderman, (1997)\textsuperscript{24}; Rawlings and Rubio, (2005)\textsuperscript{25}; Handa and Davis, (2006)\textsuperscript{26}) suggests that women are more likely to use resources in ways that improve family well-being, especially that of children. Holvoet
(2005)\textsuperscript{27} compared the gender effects of two subsidized credit programmes in southern India, the Integrated Rural Development Programme (IRDP) and the Tamil Nadu Women’s Development Programme (TNWDP) and finds that the decision-making influence of women only increases when transfers are made to women, and only for decisions about loans. Swaminathan \textit{et al.} (2009)\textsuperscript{28} also examined credit transfers to men and women across four formal credit programmes, in addition to informal credit transfers (for example, through networks of friends, family and acquaintances), and suggested that recipient gender matters for employment-related outcomes as well as status and self-esteem. In Uganda, Hoffmann (2008)\textsuperscript{29} finds that when allocated a mosquito net, women are more likely to use nets not only for their children, but tend to cover a larger fraction of household members whereas men are more likely than women to use the net for themselves (although women also do so). Hazarika and Guha-Khasnobis (2008)\textsuperscript{30}, studying all micro-credit transfers in rural Malawi in 1995, find that young girls’, though not boys’, long-term nutrition and the access to micro-credit of adult female household members are positively correlated. Fleischner (2008)\textsuperscript{31} analyses all credit to men versus women in rural Paraguay in 1999, using an observational cross sectional study and finds that household efficiency falls by an additional 11 per cent.

Even though women are active, agents of change and play a pivotal role in both the family and the society, the development processes have bypassed women and hence women still live in an unequal world. According to the UN document, women represent nearly 50 per cent of the world’s population, perform nearly two-thirds of the world’s work, receive only one-tenth of world’s income and own less than one per cent of the world’s property. Women face discrimination in birth, health, education, employment, decision-making, legal issues etc. About 70 per cent of the world’s 1.3 billion people living in extreme poverty are women and girls. Women work 66 per cent of the world’s working hours. 33 per cent of women worldwide is homeless or live in inadequate dwellings, such as slums. According to UNHCR, 80 per cent of refugees is estimated to be women and children, 16 per cent of parliamentary seats worldwide is held by women. Women own only 1% of property worldwide. Gender based violence is responsible for the most deaths of women aged 15 – 44. Hence, marginalization of women in the development has hindered the whole process of socio-economic development, has been the realization of late. A report from the
World Bank confirms (World Bank, 2001); societies that discriminate based on gender pay the cost of greater poverty, slower economic growth, weaker governance and a lower living standard for their people. The World Bank’s Empowerment and Poverty Reduction: A Sourcebook defines empowerment in its broadest sense as the “expansion of freedom of choice and action” (Narayan Deepa, 2002). United Nations (2001) has strongly emphasized women empowerment as the processes by which women take control and ownership of their lives through expansion of their choices. As such, empowerment of women is an important objective of any wholesome development process of an economy.

Since 1970s, microcredit and microfinance have been the buzzing terms in the field of development (Robinson 2001). United Nations Capital Development Fund (2005) emphasizes that because of the interconnection of the financial power, poverty, and women, microfinance has an active role in improving economic equality. Microfinance in the recent past has emerged as a potential instrument for poverty alleviation and women empowerment.
References:


