Chapter-3

CONCEPTUAL FRAMEWORK OF MICROFINANCE IN INDIA

“Progress is impossible without change,
And those who cannot change their minds cannot change anything.”

George Bernard Shaw.

3.1 Microfinance Structure in India

The Indian state put stress on providing financial services to the poor and underprivileged since independence. The commercial banks were nationalized in 1969 and were directed to lend 40% of their lendable funds, at a concessional rate, to the priority sector. The priority sector included agriculture and other rural activities and the weaker strata of society in general. The aim was to provide resource to help the poor to attain self-sufficiency. They had neither resources nor employment opportunities to be financially independent let alone meet the worker consumption needs.

To supplement these efforts, the credit scheme integrated rural development program was launched in 1980. But these supply side programs aided by computer and leakages, achieved little further, the snare of the formula financial sector in total rural credit was 56.6% compared to the informal finance art 39.6% and unspecified source at 3.8%. Not only had formula credit flow been less but also uneven. The collection and paperwork based system shield away from the poor, the vacuum continued to be filled by the
village money lender who charged interest rates of 2 to 3% per month. Seventy percent of land less farmers did not have a bank account and 87% had no access to credit from a formal source.

It was in this cheerless background that the M.F. revolution occurred worldwide. In India began in the 1980s with the formation of pockets of informal self-help groups (SHGs) engaging in micro activities financed by M.F. But India’s first microfinance institution Shri Mahila Sewa Shahkari Bank was set up as an urban co-operative bank by the self-employed woman’s association (SEWA) soon after the group (founder Ms Ela Bhatt) was formed in 1974.

The first official effort materialized under the direction of NABARD. The Mysore resettlement and development agency sponsored project on saving and credit management of SHGs was partially financed by NABARD 1986-87.

Basically the MFIs in India of three categories

(i) Next for profile MFIs, which include the WGO,
(ii) Mutual benefit MFIs, which include mutually aided co-operative credit and ;
(iii) For profit MFIs which include the non banking financial companies.

NABARD refinances the financial institution engaged in M.F. to the extent of actual disbursement. NABARD, SIDBI are “bulk financiers” who cleverly leverage resources obtained from a variety of sources.
Table 3.1: Legal forms of Microfinance Institutions in India

<table>
<thead>
<tr>
<th>Types of MFIs</th>
<th>Estimated numbers</th>
<th>Legal Acts under which registered</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Not for profit MFIs</td>
<td>400 to 500</td>
<td>Societies Registration act, 1860 or similar principal acts Indian trust act, 1882</td>
</tr>
<tr>
<td>a) NGO-MFIs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b) Non profit companies</td>
<td>10</td>
<td>Section 25 of the companies act, 1956</td>
</tr>
<tr>
<td>2) Mutual benefit MFIs: Mutually aided co-operative societies (MNCs) and similarly setup institutions.</td>
<td>200 to 250</td>
<td>Mutually aided co-operative societies act enacted by state government.</td>
</tr>
<tr>
<td>3. For profit MIFs</td>
<td>6</td>
<td>Indian companies act, 1956, reserve bank of India Act. 1934</td>
</tr>
<tr>
<td>Total</td>
<td>700 to 800</td>
<td></td>
</tr>
</tbody>
</table>

(Source: NABARD)
The estimated number is of those MFIs actually engaged in credit disbursement.

**Table 3.2:** Contribution of different segments of MFIs in the SHGs movement

<table>
<thead>
<tr>
<th>Bank</th>
<th>Cumulative no. of SHGs provided with bank loan up to March 2004</th>
<th>Cumulative no. of SHGs provided with bank loan up to March 2012.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total public sector bank</td>
<td>118855</td>
<td>516697</td>
</tr>
<tr>
<td>Total private sector bank</td>
<td>5391</td>
<td>21725</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>84775</td>
<td>405998</td>
</tr>
<tr>
<td>Co-operatives</td>
<td>12773</td>
<td>134671</td>
</tr>
<tr>
<td>Total</td>
<td>221794</td>
<td>1079091</td>
</tr>
<tr>
<td>Total Public sector banks (%)</td>
<td>53.6</td>
<td>47.9</td>
</tr>
<tr>
<td>Total private sector banks (%)</td>
<td>2.4</td>
<td>2.0</td>
</tr>
<tr>
<td>Regional rural banks (%)</td>
<td>38.2</td>
<td>37.6</td>
</tr>
<tr>
<td>Co-operatives (%)</td>
<td>5.8</td>
<td>12.5</td>
</tr>
</tbody>
</table>

(Source: NABARD)
3.2 Outreach and sustainability of Micro Finance

In spite of the optimism generated by the expansion of SHGs credit and the high recovery rate (According to NABARD 2003-04 report on SHGs credit and the high recovery rate (according to NABARD 2003-04 report on SHGs bank linkage it was more than 95%) there is a gap between actual per capita credit provided to the poor and the demand the outstanding of the SHGs programme in March 2003 were around ₹10 billion which met only 2.2 percent to 6.6 percent of the projected demand [Mahajan Vijay and Bharti Gupta Ramola (2003) ‘Microfinance in India – Banian Tree and Bonsoi’] the total disbursement of bank loans to SHGs were ₹ 2049 crore as on 31st March 2003 with an average loan of ₹ 1766 per family [RBI (2003): report on trend and progress of banking in India 2002-03]. The share of Micro Credit in Total Credit of the Indian Banking System was less than 1 percent. The transforming world of Indian of Indian microfinance – taras Nair, 2005) further, the distribution of micro finance in India was highly skewed, with 65 percent of the SHGs being is southern India and these SHGs were enjoying 75% of the credit disbursed.

3.3 Global Acceptance of Microfinance

It is claimed that this new paradigm of unsecured small scale financial service provision helps poor people take advantage of economic opportunities, expand their income, smoothen their consumption requirement, reduce vulnerability and also empowers them. Former World Bank President James Wolfensohn said “Microfinance fits squarely into the Bank's overall strategy. As you know, the Bank's mission is to reduce poverty and improve living standards by promoting sustainable growth and
investment in people through loans, technical assistance, and policy guidance. Microfinance contributes directly to this objective”. The emphasis on microfinance is reflected in microfinance being a key feature in Poverty Reduction Strategy Papers (PRSPs).

Realising the importance of microfinance, World Bank has also taken major steps in developing the sector. Formation of Consultative Group to Assist the Poor (CGAP) in 1995 as a consortium of 33 Public and private development agencies and establishment of Microfinance Management Institute in 2003 are significant landmarks. CGAP acts as a “resource center for the entire microfinance industry, where it incubates and supports new ideas, innovative products, cutting-edge technology, novel mechanisms for delivering financial services, and concrete solutions to the challenges of expanding microfinance”. MAFMI was established with support of CGAP and Open Society Institute for meeting the technical and managerial skills required for microfinance sector. CGAP has been instrumental in shaping the dominant theoretical orientation of microfinance. The guiding philosophy behind diverse sphere of CGAP activities by way of insemination of microfinance best practice, grant-making to Microfinance Institutions, and fostering national-level policy on microfinance has been ‘Commercial microfinance’. The CGAP dossier on ‘Best Practices’ and brochure on ‘Key principles of microfinance’ succinctly capture the philosophy of insistence on full cost recovery through market based interest rates and higher recovery rate of micro loans. The influence of CGAP philosophy has also shaped World Bank’s thinking on microfinance. Current World Bank President in his message to CGAP annual meeting in 2005 acknowledged this by saying “CGAP has helped build consensus around the
fundamentals of an inclusive financial system. The CGAP Key Principles of Microfinance, endorsed last year by the G8, have this year been championed by Worldwide, as a result of the CGAP system, good practice is increasingly becoming standard practice”. Other Regional multilateral development banks like Asian Development Bank also champion the cause of commercial microfinance. Outlining its policy for microfinance lends support to the logic by saying “to the poor, access to service is more important than the cost of services” and “the key to sustainable results seems to be the adoption of a financial-system development approach”. The underlying logic offered in support of this is universally based on twin arguments i.e., a) subsidized funds are limited and cannot meet the vast unmet demand, hence private capital must flow to the sector and b) the ability of the poor to afford market rates. Though, various scholars like Morduch (2000) have brought out the flaws of this Win-Win proposition like belief in congruence between commercial microfinance and poverty outreach, this paper will limit itself to analyzing as to how the focus on commercialization has relegated impact assessment to backstage.

3.4 Assessment of Microfinance

Assuming that a need assessment process concludes that there is excess demand for microfinance products and services, and that the situation is such that setting up a microfinance institution is adequate, what are the main steps forward?

Considering the fact that a wrong set up might do more harm than good there are several considerations to be done.

1. Market Analysis, competition and products
2 Institutional capacity and competence
3 Plan for reaching financial sustainability
4 Funding
5 Monitoring system
6 Reporting, audit and rating
7 Structure and ownership

1) Market Analysis

Various tools for market analysis have been developed; for different methods and experience in the field. The main challenge is to capture the demand from potential clients and address actual and potential competition.

2) Institutional capacity

Seen from a donor’s point of view, the first step would be to consider the potential in working with already existing organizations. Do they have the capacity of providing what the market asks for in a professional way, or is setting up a new institution a better way? As indicated above, most of the organizations involved in microfinance are multipurpose, and have microfinance as one of their activities. We then need to verify how they are organized, and if necessary challenge them to separate microfinance from other activities. It is of crucial importance to identify real costs and income on microfinance activities, regardless of the level of financial sustainability. Some argue that due to the nature of target groups, local economics etc. financial sustainability is merely a dream, indicating the need for subsidizing operations also in the longer run. Regardless of this argument, it is necessary to separate flow of capital due to loan activities from other transactions. In
any case, if sustainability is not perceived as a possible end goal, reengineering of the institution and/or abandoning microfinance activities should be considered.

It is worthwhile underlining that what matters is the provision of accessible financial services at reasonable costs rather than who is providing it. As a donor it is easy to “fall in love” with some partners, but this feeling for a partner should be dealt with a very objective and professional way when it comes to microfinance. Former good partners from other projects can end up being bad partners if they get into microfinance without having the skills and the internal culture it takes to handle the challenges involved.

3) Financial Sustainability

Financial sustainability is/must be a long term goal for a MFL. In order to address this issue, a checklist for budget for microfinance activities is useful.

- Identify operational costs.
- Projection on financial cross (Interests losses)
- Projections on income (donor funding operations)
- Define horizon for back even.
- Calculate interest rate.

Professional partners must be willing to charge interests rates that in the long run can make the institution sustainable. Micro credit services are expensive because of the costs involved of handling a large amount of small clients. A
sustainable interest level is therefore likely to be above the local interest level in the formal market.

4) **Funding**

In the initial face, most MFI have received donor funding for setting up the organisation. The long run goal must be financial self sufficiency, but in order to reach a large number of clients it would generally be necessary to access loans from capital providers on commercial terms. Thus the analysis of funding includes both potential donors as well as financing partners.

5) **Monitoring System**

In Norway, in a joint effort by the Norxegian Development Network (Bistandsorget) NORAD and the Ministry of Foreign Affairs (MFA) guideline for appraisal and monitoring of microfinance projects have been elaborated (Clausen 2002) These build among other on the more elaborate CGAP tools, and aim at combining the need for specific information with the necessity of a tool that is not too complicated nor costly to use. The development was based on their basic criteria; we quote.

- The formers should be simple with information strictly on a “need to know” basis
- The information required should be easily available by microfinance projects to limit the transaction cost for them in meeting donor appraisal and monitoring requirements.
The performance indicators should be simple and easy to interpret but at the same time provide comprehensive overviews of overall performance of the microfinance project.

Three sets of indicators must be considered.

- Outreach indicators: efficiency number of clients and poverty bracket (using average loan in percent of GDP per capita). Savings can be added when pertinent.
- Institutional indicators: focus on effectiveness; defined as productivity of staff (loans per staff) financial productivity (Administrative costs per loan) and efficiency (administrative costs over portfolio).
- Financial performance: portfolio risk, that is sustainability books at operational sustainability (income versus expenditures) portfolio yield and portfolio quality (arrears).

All of the above indicators do provide important information regarding the different aspects of an MFI.

Due to the variety of contexts in which MFI operate, there are no global standards for most of the indicators compare whether a microfinance project is performing well or not. However, the micro Banking presents at regular intervals some of these indicators for a samples of MFI. When it comes to outreach, a project with a strong poverty focus should have a low number for average loan in percent of GDP per capita. Regarding financial sustainability based on many empirical studies, it is becoming a common understanding
that an arrear, default rate above 5% will make a long run sustainability of the MFI very unlikely.

6) Reporting and Audit Procedures

Proper reporting is an intrinsic part of a well designed monitoring system. In addition to this external audits are necessary to establish institutional credibility. In many cases this will be a legal requirement; it is also becoming more and more a pre condition for potentially new financing partners. Due to the nature of microfinance, the audit procedures required are different from those of a “regular” NGO. Handbooks for these purposes are elaborated by a.o. CGAP.

Credit rating is gradually becoming a part also of the microfinance industry. A proper rating, carried out by professional rating institutions, is likely to become a prerequisite in order for a MFI to attract professional investors in the future. A list of qualified rates by IABD and CGAP is found at www.mfrating.org/mft_institutions/qualified_raters, html. Electronic Information Systems and internal control routines are two crucial points in professional microfinance and should therefore be included in all kinds of business planning for MFI.

7) Structure and Ownership

When a MFI grow, the question of structure and ownership becomes more important. As in any business or organisation, the main stakeholders will determine the long run. Strategy and the way the organisation is structured
and managed will be determinate for the long run performance. Thus these are key factor in assuring the permanent provision of financial services.

3.5 Role of MFIs and Commercial Banks

Micro entrepreneurs (the self employed poor) have little access to the formal financial system in developing economies. At best, formal financial institutions reach the top 25 percent of the economically active population, which leaves the bottom 75 percent without access to formal financial services.

Asia pacific region has six micro finance giants. Out of which only Reserve Bank of India is a commercial bank. There are other regulated institutions, which provide financial services to micro entrepreneurs such as rural banks and credit union. The commercial banks undertook microfinance lending only because their governments required it. These commercial banks can be classified as Government subsidized lending programs, government mandated lending targets.

The analysis done on the basis of high portfolio quality and significant scale of outreach to the poor showed that government mandated lending commercial banks were failures. They must have well designed products for micro enterprises, which can be encouraging and profitable. An appropriate regulatory and prudential frame work by the government may encourage the commercial banks to become involved in microfinance.
These microfinance models lacked scalability and hence ICICI bank came up with the following model:

![Diagram showing the model of ICICI Bank]

### Chart 3.1: Model of ICICI Bank

Some of the key differentiating points of this model from other are:

- Intermediary assumes fraction of the credit risk (to the extent of risk sharing), leading to reduction in capital required.
- Bank prices on basis of underlying asset rather than rating of intermediary.
- Transition from lending to organization to asset based lending.
- ROE of intermediary significantly improves with portfolio quality remaining unchanged.
- Scope for leverage of 10-12 times compared to 2-3 times previously.
Table 3.3: Linkage Banking and Other Microfinance Models

<table>
<thead>
<tr>
<th>Banks</th>
<th>Bank Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
</tr>
<tr>
<td>Com. Banks (27)</td>
<td>46068</td>
</tr>
<tr>
<td>Foreign Banks (40)</td>
<td>237</td>
</tr>
<tr>
<td>Other scheduled and non scheduled banks (35)</td>
<td>5420</td>
</tr>
<tr>
<td>RRBs (196)</td>
<td>14483</td>
</tr>
<tr>
<td>Total</td>
<td>66208</td>
</tr>
</tbody>
</table>

3.6 Impact of SHG- Bank linkage

SHG bank linkage program is effective in targeting poorest households as majority of beneficiaries are from among the poorer groups – landless and marginal farmers. But there has been little robust evidence available on the impact of the program on reducing poverty. There are shortcomings in methodology, insufficient time period to assess some of the impacts on poverty alleviation etc.

A study of SHGs having completed at least one year of bank linkage was conducted by NABARD in eastern areas (Orissa, Jharkhand and Chattisgarh) and the following observations were made.
Employment, average net income and value of assets increased in the period after SHGs bank linkage program was implemented.

Average savings as well as loan repayment rates increased.

Empowerment of women, greater assertiveness and participation in decision making.

3.7 Financial System Approach

The growth of microfinance in India has also to be seen in the light of financial sector reforms in India starting from 1991 and the global emphasis on commercialization of the sector. The financial sector reforms in India have focused on fostering a market based financial system by increasing competition and improving the quality of financial services. The new approach has been deeply influenced by the reorientation among international rural financial policy makers centering on concepts such as self-help, self sustained growth and institutional viability. Under the new approach, institutional viability is of prime concern and instruments of directed credit and interest rate directives have been totally diluted or been done away with. As a consequence, banks are increasingly shying away from rural lending as well as rationalizing their branch network in rural areas.

Burgess & Pande (ibid) have brought out this fact in their study by stating that while between 1977 and 1990 (pre reform period) more bank branches were opened in financially less developed states, the pattern was reversed in post reform period. Thus while, the access of the rural poor to credit through traditional bank lending has reduced in post reform period, the policy recommendation is to fill this gap through microfinance. Flowing out of
negative experiences of the earlier state intervention, institutional viability has become the focal point for evaluation of success of credit interventions. The philosophy and design of SHG-Bank linkage programme reflects this new concern vividly by emphasizing on full cost recovery in order to become an attractive proposition for banks. Siebel & Dave (ibid) in their study on commercial aspects of SHG programme succinctly state the new paradigm with focus on institutional sustainability by saying that as against the long standing tradition of government owned banks undermining rural finance with cheap credit “NABARD belongs to the new world of rural finance: it is profit making and it actively promotes the viability of rural banks under its supervision”. The design features of the programme emphasize that it does not envisage any subsidy support from the government in the matter of credit and charges market related interest rates based on the premise that submarket interest rates could spell doom; distort the use and direction of credit (Kropp & Suran, 2002). High recovery rates under the programme are used to justify the dictum that ‘poor need timely and adequate credit rather than cheap credit’. With this shift to parameters of institutional success, the issue of impact assessment has been relegated to the background. Impact assessment is either left for inference through proxy measures like volume of credit, repayment rates and outreach or one-off sample impact assessment exercises. The field research was undertaken to understand the clients perspective and analyse the factors behind repayment rates as well as impact of credit on socio economic well being of clients. The research covered 93 client households from 5 Self Help Groups from three different locations in Western and Central part of India. While statistically the number may look insignificant considering the size of the Programme,
use of participatory methods of research adds to its depth and value. Only groups which have been in the programme for at least two years were studied as groups of less than 2 years of formation may not be best suited to capture impact. As the size limitations of paper constrain a detailed enumeration of field research findings, only the key findings of the field research having a bearing on the central aspect of the paper are listed.

- All clients were saving regular amounts of money at monthly/bimonthly interval building up the group savings
- Internal loaning of group funds was very high resulting in significant waiting time for members interested in borrowing
- Social awareness index of group members as measured on Likert Scale showed a definite positive trend after joining the group
- Reliance on moneylenders for credit eliminated or decreased in case of approx 2/3rd of clients
- No specific benchmarks for group membership leading to inadequate poverty targeting
- Only 6% clients had taken up any economic activity post group formation
- Marginal increase in real term income level after joining the group
- Bank credit to group often a result of banker’s zeal to achieve targets rather than based on group demand
- Bank credit as well as loans used overwhelmingly for consumption purpose
- Group members not willing to borrow to take up economic activity on account of credit risk and absence of skills
Prompt Repayment a factor of group pressure and sourced out of reduced consumption, extra work and borrowing from other sources.

High rates of interest in internal lending among group members (2-3%) was seen by members as prescribed by the group forming agency and accepted as being better than even higher rates of informal sector.

Further summarizing the findings at the cost of over simplification, it can be said that while the programme had definite impact on building of social capital, it had marginal impact on income levels. At this point it is useful to clarify that positive contribution on social sphere is by itself a significant achievement, however the problem lies with extension of positive impact to economic activities. The findings sit uneasily with earlier evaluations of the programme in respect of economic impact, while being in consonance with social impact.

Puhazhendhi & Satyasai (2000)31 in their study commissioned by NABARD covered 223 SHGs spread over 11 states across India. The study found that 58.6% of sample households registered an increase in assets from pre to post SHG situation, an additional 200 economic activities taken up by sample households and decrease in the percentage of sample households with annual income levels of ₹22500 from 73.9% to 57%. 35covered 60 SHGs in Eastern India. The findings of this study also corroborate the findings of earlier evaluation with 23% rise in annual income and 30% increase in asset ownership among 52% of sample households. World Bank policy research paper (ibid) 2005 details the findings of Rural Finance Access Survey (RFAS) done by World Bank in association with NCAER36. The RFAS covered 736 SHGs in the states of Andhra Pradesh and Uttar
Pradesh and also points to positive economic impact. The findings indicate 72% average increase in real terms in household assets, shift in borrowing pattern from consumption loans to productive activities and 33% increase in income levels. The divergence of field research findings demands a situational analysis of the field study findings. The study sites exhibited certain common features, which can be said to be true of most of Indian rural landscape. The major occupation of group members was agriculture supplemented by other activities such as farm labour, factory labour and poultry. Being rain fed area, lack of irrigation facilities, declining terms of trade in agriculture and fragmentation of land have accentuated their vulnerabilities over a period of time. The group members lacked any specific handicraft skills and had not received any skills training for undertaking any other non farm activity. In this scenario, post SHG, the group members have been content with using the group savings and bank loan as replacement/reduction of costly borrowings from informal sources. The high rate of internal lending reflected in bank and group records was used by them for meeting their consumption and emergency requirements. Detailed interaction revealed that group members do not have the confidence to use credit for productive purposes in view of lack of opportunities and partly also ingrained through their past borrowing experience. Irrigation and depressed commodity prices act as deterrent in farm sector investments, while lack of skills and invasion of rural markets by big consumer goods companies reduce the scope for rural micro enterprises. It is striking that while globalization is exerting pressure on national level companies, their penetration into rural markets is reducing the market sphere for rural enterprises. In this scenario, it seems rather naïve to visualize flourishing of
micro enterprises through provision of micro credit. Dichter (2006) in his paper drawing on African experience rightly draws attention to both these aspects by pointing to the “infertile context” of rural settings and says “if the large majority of us in the advanced economies are not entrepreneurs, and have had in our past little sophisticated contact with financial services, and if most of us use credit, when we do, for consumption, why do we make the assumption that in the developing countries, the poor are budding entrepreneurs….”

Besides acknowledging the positive social outcomes, the field study findings also point to smoothing of consumption needs and marked reduction in dependence of exploitative informal sources of credit. These aspects are in itself a significant welfare gain; however the paper questions the extension of this to economic development which is altogether a different domain from short term crisis management. The focus on financial sustainability has meant that much of the evaluation criteria for microfinance interventions are based on institutional performance. Weber (2006) 41 says that while the virtuous impact of microfinance is used to justify its expansion, much of this assessment is based on institutional success and avoidance of engaging with impacts. Very significantly he points out this focus by observing “Thus, as long as institutional sustainability obtains, it has been fairly common practice among the policy makers-and their commissioned researchers-to interpret financial viability as indicative of the social, political and economic success of microfinance programmes” (ibid.). He also argues that such an approach constitutes the ideology and practice of neoliberals as it is based on the ontological premise that competitive financial institutions provide the foundation for entrepreneurial success and are best suited to reduce poverty.
Simanowitz & Walter (2002) correctly observe that “Microfinance is a compromise between social and financial objectives. To date most emphasis has been on financial and institutional performance”. In order to bring the social aspect back into microfinance, Imp-Act43 based on three years of action research covering 30 organisations in 20 countries has been advocating mainstreaming of Social Performance Management (SPM) to improve the effectiveness of microfinance in reducing financial exclusion and poverty. While microfinance may be a winning proposition for banks, the winning evidence on client’s side seems doubtful. The institutional approach flowing out of past negative experiences has shifted the goalpost to financial solvency but in the process missed the vital link of credit usage. In this scenario, it can be said with certainty that potential of microfinance to contribute to achievement of MDGs in India, especially reduction of poverty remains suspect. Greeley (2005) rightly notes that in absence of specific poverty targeting and mainstreaming of impact assessment, the claims about the impact of microfinance on the achievement of MDG lacks credibility. Mainstreaming of impact assessment in the SHG-Bank linkage programme will call for extra efforts and resources as also create conflict with the present focus on numerical growth. Realisation of a substantial tradeoff between sustainable economic impact and exponential growth, calls for courageous public policy decisions. World Bank policy research working paper (ibid) also points that ensuring preoccupation with achievement of numeric targets does not override attention to group quality will be a key future concern for SHG-Bank linkage programme. Though, the focused on pointing the missing link of impact in the current paradigm of rural finance focusing mainly on institutional viability, other critical issues having a
bearing on impact also merit attention. The SHG Bank linkage programme at present has no explicit social or economic benchmarks for inclusion of members into groups to be credit linked in line with the flexible approach of the programme. However, as seen above the extension of credit in infertile local context has negligible chances of leading to productive investment. Similarly inclusion of core poor in the programme, who had little experience of economic activities, also limits productive use of capital. Segmentation of credit demand based on economic and social status is key to optimum utilization of scarce resources. Robinson (2001) is probably right in observing that commercial microfinance is not meant for core poor or destitute but is rather aimed at economically active poor. She opines that providing credit to people who are too poor to use it effectively helps neither the borrower nor the lender and would only lead to increasing of debt burden and erosion of self confidence and suggests that this segment should not be the target market for financial sector but of state poverty and welfare programmes. In addition to this, irrespective of socio economic status, credit can be put to little productive use in resource deficient and isolated areas. In such areas, credit flow has to follow public investments in infrastructure and provision of forward and backward linkages for economic activities. Homogenization of service delivery without fully taking into account situational context and client needs will continue to have limited impact.

3.8 Microfinance Model of the Grameen Bank

The origin of Grameen Bank can be traced back to 1976 when Professor Muhammad Yunus, Head of the Rural Economics Program at the University of Chittagong, launched an action research project to examine the possibility of designing a credit delivery system to provide banking services targeted at
Microfinance in India: An Analytical Study of its Financial, Human Resource and Managerial Aspects of Selected Institutions

the rural poor. The Grameen Bank Project (Grameen means "rural" or "village" in Bangla language) came into operation with the following objectives:

- extend banking facilities to poor men and women;
- eliminate the exploitation of the poor by money lenders;
- create opportunities for self-employment for the vast multitude of unemployed people in rural Bangladesh;
- bring the disadvantaged, mostly the women from the poorest households, within the fold of an organizational format which they can understand and manage by themselves; and
- reverse the age-old vicious circle of "low income, low saving & low investment", into virtuous circle of "low income, injection of credit, investment, more income, more savings, more investment, more income".

The action research demonstrated its strength in Jobra (a village adjacent to Chittagong University) and some of the neighboring villages during 1976-1979. With the sponsorship of the central bank of the country and support of the nationalized commercial banks, the project was extended to Tangail district (a district north of Dhaka, the capital city of Bangladesh) in 1979. With the success in Tangail, the project was extended to several other districts in the country. In October 1983, the Grameen Bank Project was transformed into an independent bank by government legislation. Today Grameen Bank is owned by the rural poor whom it serves. Borrowers of the Bank own 90% of its shares, while the remaining 10% is owned by the government.
The concept is the brainchild of Dr. Muhammad Yunus of Chittagong University who felt concern at the pittance earned by landless women after a long arduous day's work labouring for other people. He reasoned that if these women could work for themselves instead of working for others they could retain much of the surplus generated by their labours, currently enjoyed by others. Established in 1976, the Grameen Bank (GB) has over 1000 branches (a branch covers 25-30 villages, around 240 groups and 1200 borrowers) in every province of Bangladesh, borrowing groups in 28,000 villages, 12 lakh borrowers with over 90% being women. It has an annual growth rate of 20% in terms of its borrowers. The most important feature is the recovery rate of loans, which is as high as 98%. A still more interesting feature is the ingenious manner of advancing credit without any "collateral security". The Grameen Bank lending system is simple but effective. To obtain loans, potential borrowers must form a group of five, gather once a week for loan repayment meetings, and to start with, learn the bond rules and "16 Decisions" which they chant at the start of their weekly session. These decisions incorporate a code of conduct that members are encouraged to follow in their daily life e.g. production of fruits and vegetables in kitchen gardens, investment for improvement of housing and education for children, use of latrines and safe drinking water for better health, rejection of dowry in marriages etc. Physical training and parades are held at weekly meetings for both men and women and the "16 Decisions" are chanted as slogans. Though according to the Grameen Bank management, observance of these decisions is not mandatory, in actual practice it has become a requirement for receiving a loan. Numbers of groups in the same village are federated into a Centre. The organisation of members in groups and centers serves a number
of purposes. It gives individuals a measure of personal security and confidence to take risks and launch new initiatives. The formation of the groups - the key unit in the credit programme - is the first necessary step to receive credit. Loans are initially made to two individuals in the group, who are then under pressure from the rest of the members to repay in good time. If the borrowers default, the other members of the group may forfeit their chance of a loan. The loan repayment is in weekly installments spread over a year and simple interest of 20% is charged once at the year end. The groups perform as an institution to ensure mutual accountability. The individual borrowing member is kept in line by considerable pressure from other group members. Credibility of the entire group and future benefits in terms of new loans are in jeopardy if any one of the group members defaults on repayment. There have been occasions when the group has decided to fine or expel a member who has failed to attend weekly meetings or willfully defaulted on repayment of a loan. The members are free to leave the group before the loan is fully repaid; however, the responsibility to pay the balance falls on the remaining group members. In the event of default by the entire group, the responsibility for repayment falls on the centre. The Grameen Bank has provided an inbuilt incentive for prompt and timely repayment by the borrower i.e. gradual increase in the borrowing eligibility of subsequent loans. A survey has shown that about 42% of the members had no income earning occupation (though some may have been unpaid family workers in household enterprises) at the time of application of the first loan. Thus, the Grameen Bank has helped to generate new jobs for a large proportion of the members. Only insignificant portion of the loans (6 per cent) was diverted for consumption and other household needs. About 50 per cent of the loans
taken by male members were for the purpose of trading and shop keeping. 75 per cent of loans given to female members were utilized for livestock, poultry raising, processing and manufacturing activity.

It is compulsory for every member to save one Taka per week which is accumulated in the Group Fund. This account is managed by the group on a consensual basis, thus providing the members with an essential experience in the collective management of finances. Amounts collected from fines imposed on members for breach of discipline is also put into this account. The amount in the Fund is deposited with Grameen Bank and earns interest. A member can borrow from this fund for consumption, sickness, social ceremony or even for investment (if allowed by all group members). Terms and conditions of such loans, which are normally granted interest free, are decided by the group. Factors behind success of the Grameen Bank are: participatory process in every aspect of lending mechanism, peer pressure of group members on each other, lending for activities which generate regular income, weekly collection of loans in small amount, intense interaction with borrowers through weekly meetings, strong central management, dedicated field staff, extensive staff training willingness to innovate, committed pragmatic leadership and decentralized as well as participatory style of working. The Grameen Bank experience indicates the vital importance of credit as an entry point for upliftment programme for rural poor. If a programme is to have an appeal for people living in abject poverty, it must offer them clear and immediate prospects for economic improvement. Thereafter, it is easier to sell other interventions of social development, however unconventional they may appear, once improvements in standard of living are demonstrated. The Grameen Bank clearly shows that lack of
collateral security should not stand in the way of providing credit to the poor. The poor can utilize loans and pay them if effective procedures for bank transactions with them can be established. In case of the Grameen Bank, formation of groups with a small group of like minded rural poor has worked well, and group solidarity and peer pressure have substituted for collateral security.