Chapter 6

MICROFINANCE IN INDIA AND ROLE OF COMMERCIAL BANKS IN MICROFINANCE IN GUJARAT

6.1 Introduction

The term microfinance sometimes is used interchangeably with the term micro credit. However, while microcredit refers to the purveyance of loans in small quantities, the term microfinance has a broader meaning covering in its ambit other financial and non-financial services such as savings, insurance, guidance, skill development training, capacity building and motivation to start income generating activities to enhance the productivity of credit. The taskforce on Policy and Regulatory Framework for Microfinance has defined microfinance as “Provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards”. The term “Micro” literally means “small”. But, the task force has not defined any amount. However, as per Micro Credit Special Cell of the Reserve Bank Of India, the borrowing amounts up to the limit of Rs.25000/- could be considered as microcredit products and this amount could be gradually increased up to Rs.40000/- over a period of time.—As per international perceptions a standard for South Asia roughly equals to $500. (Das Lipishree, 2012)

Microfinance scheme provides a wide range of financial services to people who have little or nothing in the way of traditional collateral. It helps them to build up assets, survive crises and to establish small business to come out of the trap of poverty. This innovative programme is reaching the poor people especially women and has an impact on their socio-economic development as well as their empowerment. This programme is becoming popular and
emerging as a powerful instrument for poverty alleviation in many countries of Asia, Africa, Europe and America.

Poverty alleviation has been the foremost goal India is starving to achieve. The contribution of microfinance in achieving poverty reduction in India till now has been noteworthy. Yet, in India -A Welfare State, apart from the State; other Non State Stakeholders including microfinance service providers are also running multiple programmes to achieve the goal and whatever poverty alleviation is achieved so far is a result of mutual efforts of them and hence it is difficult to gauge direct and sole contribution of microfinance in reducing poverty. Yet, there is no deny of the fact that microfinance has noticeably contributed to poverty alleviation by providing the poor with improved access and efficient provisions of savings, credit, insurance and other financial and no financial services. Without, permanent access to institutional microfinance, most poor households would have continued to rely on meager self-finance or informal sources, which would have limited their ability to actively participate in and benefit from the development opportunities. Poverty reduction through self employment has long been a high priority for the Government of India. Microfinance has assisted many poor not only by providing needed finances but also by helping them in developing markets for their products and by lucratively marketing their products and thus have turned them into successful micro entrepreneurs and helped them in eventually escaping poverty. Most importantly, Microfinance through Self Help Groups (SHGs) has shown the vigor of economically empowered women in achieving poverty alleviation and thus has enhanced their stature not only economically but also socially in ours male dominated society.

The case of Muntha Santha, an agricultural laborer belonging to a very poor family is just one instance of success saga of microfinance. Due to very meager income it was very difficult for her family to live a good life. She came to know about the SHGs being formed by a local NGO called Gramasiri. She joined the SHG and got micro-credit assistance from Rashritya Mahila Kosh
(RMK) through the NGO to start a small business. She started a small vegetable vending shop. In this business she got a good profit and as such purchased a shop. The income from the vegetable shop has raised her economic status. Now she is able to give good education to her children. The micro-credit support has helped Mrs. Muntha Santha live a life of dignity, respect and self-reliance. Mrs. Muntha Santha now intends to construct a good house and lead a comfortable life. Mr. Muntha Santha says that it would not been possible if there would have no financial assistance from RMK and GRAMASIRI – NGO.4 This is just one example of how microfinance lets fight and escape poverty.

It is interesting to how this wonderful tool of poverty alleviation-Microfinance emerged and evolved on Indian scene. In the present chapter a study of microfinance in Indian context is made followed by the assessment of role of commercial banks in microfinance in Gujarat.

Though, Microfinance as a model appeared late on Indian Scene, it was already present and operational at an ideological level. Its manifestation on Indian landscape has been evolutionary rather than revolutionary. To comprehend how microfinance sector functions in India it is necessary to understand demand for credit by poor, major initiatives in providing credit to poor, the systematic steps towards microfinance and models adopted by microfinance service providers in India. Looking at rising interest in microfinance; before preparing the final draft for the Eleventh Five Year Plan (2007-12) which focuses on inclusive growth, the planning commission of India had appointed a steering committee consisting of the experts in the field to look into the performance of microfinance sector in India which submitted its report in 2007. Drawing from guidelines in the report and adding the present realities an analysis of microfinance sector in India is made here. The Twelfth Five Year Plan (2012-17) which focuses on “Faster, More Inclusive and

Sustainable Growth” and aims poverty reduction by 10 percent by the plan period demands more robust contribution from microfinance in achieving the goal.

6.2 A Study of Microfinance in Indian Context

To understand how microfinance functions in India analysis has been made with respect to type and pattern of credit demanded by poor in India, major initiatives in providing credit to poor in India, the systematic steps towards microfinance in India and models adopted by microfinance service providers in India. All these aspects are discussed below and finally conclusion is made with respect to functioning of the microfinance sector in India.

6.2.1. Understanding Demand for Credit by Poor

While technology and finance hold the key to ameliorate poverty, the poor in India do not have adequate access to the formal banking sector. Inaccessibility of the poor to the formal/institutional banking sector is mainly due to the following reasons

(a) Lack of good retail outlets offering banking services, (b) lack of assets with the poor that could be used as collaterals and (c) illiteracy of the poor. The credit requirement of the poor in India has been estimated by the World Bank to be around Rs.50,000 crore per annum in 2002. Against this requirement, the credit outstanding of the poor with the formal banking sector is stated to be Rs.5000 crore or ten per cent of the total demand.\(^5\)

In India the requirement of finance by the poor are for both production and consumption purposes. Production loan may be of three types, viz. (a) short term (for periods up to 15 months), (b) medium term (from 15 months to 5 years) and (c) long term (for periods above five years). Economic activity may

\(^5\) World Bank, India : “Scaling-up Access to Finance for India’s Poor”
relate to the various sectors like crop husbandry, animal husbandry, poultry, fishery, cottage & village industries, handicrafts, transportation, repair shops, and trade & services etc. For, instance in rural areas short term loans may be required by the poor for purchasing High Yield Variety (HYV) seeds, fertilizer, for irrigating a leased-in land etc. Medium term loans may be required for purchase of bullocks (or tractor) and for purchase of machinery and equipment etc. Long term loans may be required for repayment of loans, for constructing a shed/shop and for purchase of land etc. What needs to be appreciated is that all the three kinds of production loans are relevant to the poor. However the recent strategy adopted by various MFI/Banks is to ensure flexibility in lending and in repayment based on the capacity of the borrower to earn enough to repay- whether it is daily, weekly, monthly or seasonal.

About two-thirds of the estimated credit requirement of the poor is said to be on account of consumption needs. Nearly three-quarters of this consumption need (Rs.25, 000 crore) is stated to meet emergencies like illness and household expenses during the lean seasons. It is worth mentioning that due to lack of employment, and incomes during the lean seasons, the poor are often not in a position to buy subsidized food grains from the Targeted Public Distribution System (TPDS). If, consumption loan can be made available through micro credit by the formal banking sector, the poor will benefit not only by way of lower interest rate but also in terms of realizing the subsidy on food grains/items of TPDS. Alternatively, food grains credit could be provided directly under TPDS. It is important to note that consumption loans are also as relevant to the poor as production loans.

Availability of finance, moreover, tilts the employment scenario in favor of self-employment vis-à-vis wage employment. There is definitely a need to increase

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the flow of micro credit, both for consumption and production, to both the urban and the rural sector.

6.2.2. Major Initiatives in Providing Credit to Poor

Government’s initiative to reduce poverty by improving access to financial services to poor started since independence. India’s overwhelming majority of poor is located in rural areas and this motivated the government to give special attention to rural credit. Following the report of All India Rural Credit Survey in mid 1950’s, the State (The Government of India) took crucial steps in reviewing Cooperative structure including the partnership of the government in cooperatives. Also the policy initiative of ‘social banking’ concept described as “the elevation of the entitlements of previously disadvantaged groups to formal credit even if this may entail a weakening of the conventional banking practices” led to the nationalization of commercial banks in 1969, adoption of direct lending programmes to rural areas and development of credit institutions such as Regional Rural Banks (RRBs). Government initiatives during the Fourth Plan focused on marginal farmers and agricultural laborers bringing individual family as the basic borrowing unit. Integrated sustainable income generating activity was promoted through subsidized lending under Integrated Rural Development Programme (IRDP) and its subsequent variations including the self-employment programme known as Swaranjayanti Gram Swarojgar Yojana (SGSY).

The recommendations of Shivaraman committee (1978), with its emphasis on increasing flow of formal credit to poor by banking sector led banks to be active in this direction and they took innovative steps by launching schemes like pigmy deposit schemes and mobile banking to reach un served areas and un served people. Apart from commercial banks Regional Rural banks (RRBs), Local area banks (LABs), District Cooperative Credit Banks (DCCBs) and Primary Agricultural Credit Societies (PACS) have also contributed to achieve this objective. Here, below these initiatives are discussed.
6.2.2.1. Shivaraman Committee (1978)

Looking into all aspects of consumption credit for the poor, the Expert Committee on Consumption Credit (Chairman: Shri B. Shivaraman, Member, Planning Commission) recommended for allowing a line of credit to poor households by the formal banking sector. Examining the consumption need of the poor in 1976, the Committee recommended a line of credit equal to Rs.750 per household. The specific consumption demands identified by the Committee were: (a) medical expenses (33%), (b) marriage (33%), (c) education (13%), (d) birth, death and religious purposes (10%) and (e) general consumption (10%).

The co-operative credit structure was to be the main pillar of this drive. The Committee further recommended for legislative reforms in all states for universal membership in all the Primary Agricultural Cooperative Credit Societies (PACS) across the country. With regard to the rate of interest, the Committee observed that the rate charged by both cooperative banks and commercial banks on consumption loans should be the same as crop loans given for the production purpose.

It further observed, ‘The cost of servicing the consumption loans will perhaps be even higher than the agricultural loans, therefore, to expect the societies to operate on smaller margins than on the agricultural loans will be unrealistic’. On the premise that the risk to the banking sector in the case of consumption loan is higher than the production loan, the Committee recommended for a higher percentage (10%) of risk cover by the Government than usually done for other (rural) loans extended by the co-operative and commercial banks. On the estimated demand for consumption loan of Rs.170 crore (in 1976), it provided for Rs.17 crore as Risk Fund. This fund, moreover, was required to be shared equally by the Central and the State Governments.
However, despite all its moorings there was not much progress with regard to flow of consumption credit to the poor by the formal banking sector. Legislative reforms vis-à-vis universal membership in PACS was introduced; but the co-operative banks themselves became weaker and weaker in the subsequent years.

Over the years the following results were achieved due to the above initiatives.

(i) The share of non-institutional sector in rural credit that was 91 per cent in 1951 went down to 45 per cent in 1991.

(ii) The share of institutional sector that stood at 9 per cent in 1951 went up to 53 per cent in 1991.

(iii) The share of credit cooperatives in rural credit that was 4.6 per cent in 1951 went up to 29 per cent in 1981, but declined subsequently to 19 per cent in 1991.

(iv) The share of commercial banks in rural credit that was 1.1 per cent in 1951 went up to 29 per cent in 1981 and has remained at the same level in 1991.

(Reserve Bank of India’s All India Rural Credit Surveys, 1991)

The above mentioned percentages are, however, based on aggregate figures and do not throw much light on transformation in rural credit vis-à-vis credit given to poor in rural areas. There has not been any rural credit survey at the all-India level since 1991.

6.2.2.2. Banking Sector Initiatives in Reaching the Poor

Various programmes were initiated by banks to inculcate savings habit and to provide financial assistance. The initiatives being Pigmy deposit scheme and mobile banking.

6.2.2.2.1. Pigmy Deposit Scheme – The Pigmy deposit scheme intended to collect tiny deposits from the depositors from their doorsteps. The scheme
was implemented by a few banks by engaging local people. The experience of the banks was not encouraging as there were large scale cash leakages, frauds and reconciliation problems. Most banks found the scheme unattractive.

6.2.2.2. Mobile Banks – Some of the banks started mobile banks in rural areas. The location and time of operation were usually synchronized with the market days so that the large number of people could transact business. This programme was dropped because of the man power constraints.

Regional Rural Banks (RRBs) were intended to serve the people not covered by co-operatives and commercial banks. But, they were not able to serve the purpose as they were more focused on profitability and strong balance-sheets. In spite of this, it was found that the RRBs are better equipped to serve poor because of the understanding of the local conditions. However, they are not as mammoth as Commercial Banks and hence their overall contribution remains lower compared to the later.

Local area banks (LABs) aimed to mobilize rural savings by local institutions and makes them available for investment locally. They were set up in private sector and regulated by RBI. The working of LABs has not been very encouraging. One serious drawback was absence of refinancing facility. Krishna Bhima Samrudi, the local area bank in Andhra Pradesh is only one into the business of microfinance on a large scale.

India today has an extensive banking infrastructure comprising over 30,000 rural and semi-urban branches of commercial banks, over 14,000 branches of Regional Rural banks (RRBs), around 12,000 branches of District Cooperative Credit Banks (DCCBs) and 1,12,000 Primary Agricultural Credit Societies (PACS) at the village level (around 66,000 PACS are stated to be functional;
the remaining are dormant). However, their potential is not fully harnessed for the above purpose.

All the above mentioned details show that all the efforts by the government were made to make the formal credit accessible to rural India where majority of the population live. The main focus was towards increasing formal finance sector presence in rural areas, and especially for the agriculture sector. The majority of the credit went to the agriculture sector and that, too to the better off. The real needy; the poor remained untouched. Though, the contribution of the formal sector grew in a considerable amount; the informal sector remained the main source for the poor. The financial needs of the urban poor seems to be completely unheeded by the government machinery.

It was the SEWA Bank which targeted providing credit and other financial services to the real needy- the poor and in the real sense introduced the concept of microfinance in India. Though, the SEWA Bank started in 1974, its success started being visible only as late as in early 90’s. Looking at the success of SEWA Bank many private sector players entered the field and targeted directly the poor. As these institutions have entered the field voluntarily and not on any compulsion they invented models of providing financial service to the poor in such a way which in turn emerges as a win-win situation, as it satisfies needs of the poor and at the same time ensure good returns to the service providers as well. Looking at the success of the model even the government linked institutes adopted it and entered in the field with this model. Here, below the systematic rise and growth of microfinance sector in India is discussed.

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6.2.3. The Systematic Steps towards Microfinance

Microfinance started gaining its distinct identity with success of programmes and model adopted by SEWA bank. The further initiatives in this direction by National Bank for Agriculture and Rural Development, Rashtriya Mahila Kosh and Small Industries Development Bank of India strengthened the microfinance concept and its ideology. The success of Self Help Group (SHG)-Commercial Bank Linkage Programme proved that foray of commercial banks in this sector can make it more robust and credible. The centre government has created Microfinance Development and Equity Fund and Microfinance Programme to provide financial support to the players operating in this sphere. The introduction of Micro Finance Sector (Development & Regulation) Bill, 2007 in parliament and the appointment of Malegam Committee by the centre government in 2011 have led to bring transparency in this sector so that genuine players can flourish and the poor can get credit on better terms. Swabhimaan Scheme announced in the budget in the same year, 2011 has reiterated financial inclusion and microfinance as an effective tool to achieve that. All these gradual and systematic steps have built strong foundation for microfinance in India. These steps are discussed below.

6.2.3.1. SEWA Co-operative Bank (1974)

The implementation of formal lending programmes towards the poor suffered from various difficulties such as of exact targeting, screening problems of distinguishing good and bad borrowers and usually lending agencies had not been able to ensure the productive usage of loans. Also, the high transaction costs incurred in lending to the poor made the formal lending agencies leave the poor un-banked.

The origin of microfinance can be traced to the establishment of the SEWA cooperative bank in 1974, to provide banking services to the poor women employed in the unorganized sector in Ahmedabad in Gujarat. As of December, 2011, the total deposits stands at Rs 112 crore and loans dispersed
stands at 52 crore. The success of the SEWA Bank Model brought to notice the potency of Self Help Groups (SHGs) and then onwards efforts were made by various players to adopt this model.

SHGS comprise a group of 15-20 members. The groups begin by savings which are placed in a common fund. The pool of savings is created by members which later become the backbone of getting access to the loan from the Bank/MFI. Group selects its leader and the selection of the leader is based on rotation. The SHGs have, moreover, emerged as a form of “social collateral” substituting other forms of ‘collateral security’ insisted upon by lenders and thus making loans accessible to them.

Besides, SEWA has done a wonderful job in redefining the sector, before its presence it was thought that poor need only credit, the savings by them was an ignored concept. SEWA has in fact put the sector from micro credit to microfinance, the later one being more inclusive as it includes savings, insurance and pension needs of the poor and also acknowledges that the non financial services provided to the poor are highly valuable to them. It has done a noticeable job in inculcating saving habits in the poor and in providing them with non financial support as well. Looking at the success of SHG model apart from MFIs; government affiliated agencies like NABARD, RMK (Rashtirya Mahila Kosh), SIDBI and later on even commercial banks had adopted the SHG Model and now the poor both in rural as well as urban areas are treated as the target group.

6.2.3.2. National Bank for Agriculture and Rural Development Initiative, 1992

NABARD, during the early eighties, conducted a series of research studies in association with MYRADA (a leading NGO from South India) and also independently which showed that despite having a wide network of rural bank

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8 Report of SEWA Annual General Meeting, December 2011, Ahmedabad
branches that implemented specific poverty alleviation programmes and self-employment opportunities through bank credit for almost two decades, a very large number of the poor continued to remain outside the fold of the formal banking system. These studies also showed that the existing banking policies, systems and procedures, and deposit and loan products were perhaps not well suited to meet the most immediate needs of the poor. It also appeared that what the poor really needed was a better access to these services and products, rather than cheap subsidised credit. Against this background, a need was felt for alternative policies, systems and procedures, savings and loan products, other complementary services, and new delivery mechanisms, which would fulfill the requirements of the poorest, especially of the women members of such households. The launching of its Pilot phase of the SHG (Self Help Group) - Bank Linkage programme in February 1992 could be considered as a landmark development in banking with the poor and new saga in the chapter of poverty alleviation. The small beginning of linking only 500 SHGs to banks in 1992, had grown to over 0.5 million SHGs by March 2002 and further to 8 million SHGs by March 2012.\(^9\)

Recognizing the role played by MFI, in extending micro finance services in the unbanked areas, NABARD extends support to these institutions through grant and loan based assistance. NABARD provides loan funds in the form of revolving fund assistance (RFA) on a selective basis to MFI, to be used by them for on-lending to SHGs. Up to March, 2012; such support provided to MFI stands at mammoth amount of 21 crore and apart from that NABARD provides refinance facilities to MFI and banks providing microfinance to the poor and up to March 2012 cumulative refinance released stands at Rs 18,000 crore.\(^10\) It is hard to imagine the growth of microfinance sector in India without the financial support by NABARD.

\(^9\) Report of NABARD on Status of Microfinance in India 2011-12, Mumbai.

\(^{10}\) Report of NABARD on Status of Microfinance in India 2011-12, Mumbai.
Apart from financial support other non financial initiatives by NABARD are also of great value to the poor that helps them eventually come out of the plight of poverty, some of them are listed below

- **NABARD** has launched the 'Micro-Enterprise Development Programme' (MEDP) for skill development with the basic objective to enhance the capacities of matured SHGs to take up micro enterprises through appropriate skill upgradation. The programme envisages development of enterprise management skills in existing or new livelihood activities, both in farm and non-farm sectors.
- **NABARD** also provides marketing support to the SHGs for exhibiting their products.
- **NABARD** has been organising/ sponsoring training programmes and exposure visits for the benefit of bank officials, NGOs, SHGs and Government agencies to enhance their effectiveness in the field of micro finance.
- **NABARD** keeps on continuously indulging in research projects to enhance depth and width of microfinance in India and develop models that in turn leads to empowerment of poor and accomplish poverty alleviation.

### 6.2.3.3. Rashtriya Mahila Kosh (RMK), 1993

The success of the concept of micro-credit through self help groups (SHGs) encouraged the Government of India to establish a National level Micro-Credit organization /Rashtriya Mahila Kosh (RMK) (National Credit Fund for Women) under the Ministry of Women and Child Development in 1993, with an initial corpus of Rs.31 crore. The objective of RMK is to facilitate credit support or micro-finance to poor women to achieve economic independence by extending financial support for Income generation, Assets creations, Assets redemption and sustenance of their existing employment as an instrument of socio-
economic change and development. It provides loans to poor women for all purposes including loans for

- Income generating activities.
- Production activities.
- Consumption activities.
- House construction activities.
- Education and skill up-gradation.
- Purchase of land, redemption & land leasing etc.

And hence works for improving their socio-economic status. RMK had disbursed cumulative loan of Rs 151 crore up to July 2006, benefiting 5.50 lakh poor women and the recovery rate is above 91%. 11 RMK has extended its network across the country including Anadaman & Nikobar islands and border areas of J&K. As on December 2012 it has disbursed cumulative loans up to 274 crore benefitting 7.18 lakh poor women12 and thus is contributing significantly to the goal of poverty reduction.

6.2.3.4. Small Industries Development Bank of India (SIDBI), 1994

In 1994, Small Industries Development Bank of India (SIDBI) launched a pilot scheme to provide financial assistance by way of loans to NGOs for providing credit to the poor households, especially women headed SHGs. A small amount of grant also accompanied the loans so as to build capacity of the intermediates and end-users. The programme did not achieve the desired objective. A large number of NGOs were not able to scale up their lending operations because of difficulties like interest rate cap on lending, security.

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stipulations etc. SIDBI reoriented its Microfinance Programme in 1999 by addressing the weakness of the pilot scheme, the programme has taken off slowly and now provides funds to MFIs with proven record to lend the same to the poor. Today, SIDBI is one of the largest providers of microfinance through the MFIs. Up to March, 2012 it has provided loans upto Rs 1500 crore to MFIs which in turn lend to the poor.  

6.2.3.5. SHG-Commercial Bank Linkage Programme (1996)

Impressed by the mechanism of SHG Model, the commercial banks also tied up with SHGs when Reserve Bank of India in 1996 under its guidelines included financing of SHGs as a main stream activity of banks under the priority sector lending programmes. Since then the SHG-Commercial Bank linkage programme has been showing positive results.


6.2.3.6. Microfinance Development and Equity Fund (MD & EF), 2001

Government of India, in 2001 re-designated the then existing Microfinance Development Fund as Microfinance Development and Equity Fund with the objective of facilitating and supporting the orderly growth of the microfinance sector, by especially assisting the women and vulnerable sections of the society and also by supporting their capacity building. As against a total corpus of 200 crore contributed by RBI, NABARD and commercial banks, the actual (cumulative) utilization of the fund stood at `278.31 crore as on March 2012. NABARD has been augmenting this fund from its own resources for promotion

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13 Annual Report SIDBI, Mumbai, 2012

14 Report of NABARD on Status of Microfinance in India 2011-12, Mumbai.
of various micro-finance activities such as formation and linkage of SHGs, training and capacity building of stake holders, livelihood propagation, studies, documentation, etc. so that Microfinance sector emerges as a powerful means for achieving poverty alleviation.

6.2.3.7. Microfinance Programme (MFC), 2004

In March 2004, the Ministry of Small Scale Industry introduced the Microfinance Programme along with the SIDBI. The ministry provides funds to SIDBI, called “Portfolio Risk Fund (PRF)”. This fund is used for security deposit required by the MFIs/ NGOs to get loan which in turn lend to micro enterprises.

6.2.3.8. Micro Finance Sector (Development & Regulation) Bill, 2007

The objective of the bill is to ensure development and orderly growth of the micro-finance sector in rural and urban areas, to make it more transparent and robust and to make NABARD the sector regulator.

6.2.3.9. Malegam Committee, 2011

The formal players in microfinance sector in India can be categorized in two parts one is banking sector that includes commercial banks, cooperative banks ,RRBs, SIDBI and NABARD and the other is Microfinance Institutes (MFIs) including NGOs providing microfinance services. While the banking sector is regulated by NABARD and RBI who regulate and monitor their activities in the field, there is no authority to regulate and check MFIs. Hence many instances are coming out about the malpractices done by some of the MFIs. To look into the matter Malegam committee was set up in 2011. The recommendations mainly cover the aspects like cap on interest to be charged from borrowers, the maximum amount to be lent, corporate governance principles to be followed by MFIs, Capital Adequacy Ratio (CAR) to be maintained by them and so on. The basic objective of this committee is to check the unscrupulous players and to create an environment in which
genuine players can flourish and can cater to the needs of the poor. The details of the main recommendations of the committee are given in the annexure.

6.2.3.10. Swabhimaan Scheme, 2011

Launched on February, 2011, is an innovative scheme to take banks to the door step of the poor instead of the latter having to go in search of banks. The idea is to have business correspondents, or bank saathis, (who may be the local merchant) armed with electronic hand-held devices, which can recognize the bio-markers of bank customers. The customers can then deposit and draw money directly from the bank saathi, without having to travel long distances to get to the nearest brick and mortar bank branch and in turn to achieve financial inclusion.

The above discussion has revealed how the foundation of microfinance in India was laid and efforts made to strengthen it. After identifying the systematic evaluation of microfinance in India now the models adopted by microfinance service providers in India are discussed.

6.2.4. Models adopted by Microfinance Service Providers in India

The formal microfinance sector in India mainly comprises of banks and Microfinance Institutes. Their modus operandi is discussed here.

Landlords, local shopkeepers, traders, suppliers and professional money lenders, and relatives are the informal sources of micro-credit for the poor, both in rural and urban areas. Some of the perceived advantages of informal loans are (a) contractual flexibility, (b) lower discrepancies between loan sanctioned and loan received and (c) less reliance on collateral.

Emphasis on collateral security is, however, not totally absent under informal loans as money lenders keep jewellery and kitchen ware as physical security and are known to mortgage land and house against loans. An overwhelming
majority of poor have been borrowing money based on pledging “self-labor” as collateral. They are known as bonded laborers. This category of borrowers is the most vulnerable as harsh contracts linking labor to loans are imposed. Bonded labor is the extreme form of this collateral and in the previous chapter the analysis has revealed that they are the poorest of the poor.

The interest charged on informal loans is stated to vary between 24 per cent to 48 per cent per annum. In certain regions, it even goes up to 120 per cent per annum. The Money Lender’s Acts enacted by various states are intended to check the exploitation of the poor by the money lenders. They cannot charge exorbitant rates of interests; in fact, in most cases there is an upper ceiling on interest rates and the total recoveries cannot exceed twice the amount of ‘the principal’. However, such provisions are rarely enforced due to various reasons.

The formal sector consists of banks and MFIs including NGOs providing microfinance services. In India, majority of microfinance activity is under the ‘Banking model’ and 10-15% of the activity is through ‘MFI model’. Here, first the modus operandi of banks is discussed and then that of MFIs which work by adopting agency model or bulk lending model is discussed.

6.2.4.1. Banks as Microfinance Service Provider

Banks in India don’t transact directly with individual clients in this sector. It operates through SHG Model. According to RBI Guidelines, banks may give loans to SHGs up to Rs. 5 lakh without insisting on collateral security. The Bank-SHG linkage programme is noticed to have encouraged thrift/savings amongst the poor. Formulation of SHGs is, however, dependent on the intervening agency, who has so far been NGOs, MFIs, RRBs, and DRDAs (District Rural Development Authorities). Under this model SHGs are being

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15 Reports of NABARD on Status of Microfinance in India 2007-2008 to 2011-12, Mumbai.
promoted primarily under the two separate schemes of NABARD/Ministry of Finance and the Ministry of Rural Development.

There is another important difference between the two. While the SHGs promoted by the Ministry of Rural Development enjoys credit-linked subsidy, those promoted by NABARD do not have any such facility. Despite this, the credit disbursed to SHGs under the NABARD programme has been more than under SGSY.  

6.2.4.2. MFI as Microfinance Service Provider

MFIs in India register themselves either as societies (under the Societies Registration Act, 1960), as trusts under the Trust Acts, as Non-Banking Financial Companies (NBFCs), or as Local Area Banks (LABs). The MFIs operate under any of the two ways it can either act as an agent of the bank or can act on its own. The first model is called the agency model and the other is called the bulk lending model. Both the models are explained in detail here.

6.2.4.3. Agency model of MFI

Under this model, MFIs are appointed as ‘Business Facilitators' (BFs) or as ‘Business correspondents’ (BCs) by banks. In the former case, the MFIs provide the non-financial services, such as, identification of borrower, processing and submission of applications to banks etc. In the latter case, the MFI provide financial services as “pass through” agents for disbursal of small value credit, recovery of principal / collection of interest or sale of micro insurance / mutual fund products etc. The loan amount, however, remains in the books of the bank. The banks need not obtain prior permission from RBI for appointing BCs and BFs. They are required to conduct thorough due diligence before appointing BFs/BCs, and as principals, are responsible for customer service and control operations.

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16 Ministry of Rural Development (GoI), Annual Report (2004-05), New Delhi, 2005.
The banks also need to have operational guidelines for the purpose. The MFIs, moreover, provide First Loan Default Guarantee (FLDG) equal to 8 – 15 per cent of the limit sanctioned in the form of security deposit with the bank so as to maintain its stake in the loan portfolio. The banks appear to have positive experience under this model as the MFIs have helped them overcome the problem of outreach in rural areas and have also reduced their transaction cost. In brief, the agency model of MFI is bank driven.

6.2.4.4. Bulk Lending Model of MFI

While the Agency model may appear more appropriate in the case of small MFIs, the larger MFIs may like to operate independently of banks. This category of MFIs belong to MFI Bulk Lending model whereby they can access funds in the form of cheaper loans, subordinated debts, equity or quasi-equity from market, from donors or from other agencies. All the savings they receive in the form of deposit and all the money they lend as loans appear in their own books. Though they are governed by the statute under which they are formed there is no regulator to regulate their business activities and hence the rate of interest at which they give loan and the rate of interest they provide on savings to the members may vary from institute to institute. Besides, they provide non financial services, too to their clients in the form of market research, skill development, selling etc.

However, the experience in the Indian context has shown that more transparency and better outreach to poor can be achieved when banks and MFIs work together as involvement of banks can bring in transparency and that of MFIs can enhance outreach to the poor.

6.2.5. Conclusion

The above details threw a light on the microfinance sector in India.

The formal players are doing a noteworthy job by catering to the financial needs of the poor who so far have been un-banked. Apart from existence of
money lenders and other informal players the formal microfinance sector in India faces various challenges. The most visible are summarized here.

6.2.5.1. Capacity Building

The sector which is still in its infancy in India faces shortage of experienced consultants, manpower and experts. There is a need to have good quality professionals, trained in best practices for effective corporate governance. A need-based capacity building programme to meet the requirements of all categories of MFIs is essential to bring about sustainability in the sector. Some of the important areas where capacity building is needed are transformation, best practices, interest rate management, delivery management, managing growth, risk mitigation, product designing and market research.

6.2.5.2. Unbalanced Geographical Growth

The sector has witnessed an exponential growth during last decade especially in southern part of the country. Some of the small scale NGOs have grown into large corporate institutions with some of them having more than one lakh membership. A survey conducted by NABARD in 2008 reveals that there is high geographic concentration (75%) of MFIs in two States viz., Andhra Pradesh and Tamil Nadu. Most of these MFIs are found to operate in Andhra Pradesh only. The industry must be geographically dispersed.

6.2.5.3. Transparency

In many cases there is absence of transparency regarding interest rate and other charges to the borrowers. Many times proper records are not maintained and there is no statutory requirement of audit. The poor people often fail to understand the meaning of compound interest rates. A poor farmer told that he has to pay 10 per cent interest rate per month tends to believe that he will be paying an interest of 120 per cent over the year. However, if the 10 per cent interest rate is meant to be a compound rate, then this works out to an interest
of 214 per cent over the year. To misunderstand this can lead the borrower to make huge losses and the lender to make huge, unfair profits. So, the MFIs must clearly explain the terms to the poor.

6.2.5.4. Scattered Players and Absence of Policy

The microfinance sector as a whole is highly decentralized with no single agency responsible for its development. Though Banks are required to report their activities in the field to RBI and NABARD, the same is not the case with other MFIs. Hence Information/data on the sector is scattered and there are no firm estimates about the sector. Insufficient information impedes understanding and policy formulation. For a better understanding, monitoring and future planning there is a need for collection and compilation of information regarding the number of SHGs/MFIs, the loans disbursed, deposits, interest rates etc. The scattered research carried out by various agencies also required to be consolidated. Besides, absence of any explicit policy on Microfinance adversely affected its growth. However, the 'Micro Finance Sector (Developments and Regulations) Bill', 2007 is presently under consideration; no final regulator for the sector has been appointed yet. This retards effective performance of the sector.

The reports of unfair practices by some MFIs to recover loans and consequent suicides by poor borrowers attributed to these practices have led to high criticism of the sector. These developments have put the microfinance sector at crossroads in India. In regulating MFIs it has to be recalled that they have played a major role in drawing poor people into India’s mainstream finance and enabling farmers to make useful investments and marginal workers to start up small self-employed enterprises. There is evidence that some of these people have been subjected to unfair threats to make them repay loans. Such practices must be stopped. However, to react to this by announcing blanket amnesties and encouraging borrowers to default en masse will do more damage than good. Such practices would lead to the sector disappearing
since no player, whether it be profit-making one or a non-profit, would want to give out loans knowing that these will not be recovered. While we must recognize that borrowers in special situations have the right to plead bankruptcy and not pay back, we need an intelligent regulatory structure which protects borrowers and, at the same time, allows lenders earn a reasonable margin.

A transparent mechanism, regular audit of the players, achieving product breath by incorporating innovative tools based on the requirements of the poor, making the industry geographically diversified and involving more and more players especially commercial banks by letting them charge market determined interest rate with upper cap of 24% per annum, the same rate which MFIs can charge as per Malegam committee recommendation, instead of compelling them to lend at PLR, can enable the sector to flourish and help the poor to come out of the trap of usurious interest rate charged by moneylenders. All the apprehensions should be addressed and proper framework should be put in place so that genuine players can burgeon and cater to the needs of the poor and leads to poverty alleviation.

Of course, it should be remembered that microfinance is for economically active poor because he who doesn’t even earn enough to feed him self on day to day basis cannot be expected to save nor can credit given to him be expected to be put in some productive activity instantly. For this type of poor the employment and social security programmes can only be expected to serve the purpose.

6.3 Role of Commercial Banks in Microfinance in Gujarat

Commercial banks world over are facing increasing competition in their traditional retail markets. This is causing margin squeeze. It is also leading forward thinking banks to explore new potential markets that can generate growth in client numbers at acceptable profit margins. Besides, insistence on part of national governments for entering into microfinance sector, increasing
competition in traditional market, increasing size of microfinance sector and success stories of MFIs are making commercial banks foray into microfinance in countries across the world especially in the developing ones. As the entry of commercial banks in microfinance is relatively a recent phenomenon a very scant amount of literature is available. So, it is too early to assess commercial banks’ effectiveness in serving the sector. However, Jennifer and Porteous (2005) have done one pioneering study on the considerations made by commercial banks before entering microfinance segment. They give a brief outlook of strategic decisions to be made by commercial banks while entering microfinance segment.

They have found that there is no single approach to enter into microfinance sector. For one thing, different banks will have different business goals and the competitive and regulatory environment will vary. Banks have a wide range of approaches to choose from. Some banks enter the market directly by expanding their retail operations to reach the "micro" level by creating an internal unit or launching a separate company, such as a service company or specialized financial institution. Others take an indirect approach by working with existing microfinance providers. In a nutshell, they have identified two major decision criteria with respect to entering into the market first whether to enter the segment or not, and if yes then whether to provide service directly to the microfinance clients or to work through existing microfinance players. The authors have created a decision tree showing different strategies calibrated by the commercial banks in different countries in this regard. It is presented below.
Consider the example of Ag Bank Mongolia, which is providing microfinance services directly by creating internal unit. The ICICCI Bank is working through existing service providers by outsourcing retail operations.

Though literature is limited, it tilts in favor of commercial banks’ entry in the field. These banks should enter the segment because of the competitive advantage enjoyed by them in this sphere. Some of the advantages available to commercial banks vis-à-vis other players are
• Commercial banks are regulated institutions fulfilling the conditions of ownership, financial disclosure, and capital adequacy that help ensure prudent and transparent management.

• They have physical infrastructure, including a large network of branches, from which it is easy to expand and reach out to a substantial number of microfinance clients.

• They have well-established internal controls and administrative and accounting systems to keep track of a large number of transactions.

• Their ownership structures tend to encourage sound governance structures, cost effectiveness, and profitability, all of which lead to sustainability.

• Because they have their own sources of funds (deposits and equity capital), they do not have to depend on scarce and volatile donor resources (as NGOs/MFIs have to).

• They can offer a variety of products attractive to microfinance clientele.

All of these advantages can give commercial banks special edge over other players. The performance of commercial banks in Gujarat in microfinance is discussed in detail here below.

Gujarat is among India’s fastest growing states in terms of per capita income and state income. However, its growth performance in microfinance sector vis-à-vis other states is less than exemplary. It is found that Commercial Banks in Gujarat have adopted SHG-Bank Linkage model. The performance of SHG-Commercial Banks Linkage model in Gujarat during 2004-11 period is evaluated.
6.3.1. SHGs in Gujarat

At present SHGs in Gujarat may be divided in two groups viz., NABARD or NGOs promoted SHGs and the state government promoted women SHGs, i.e., Sakhi Mandals (SM). Sakhi Mandals are state sponsored exclusive women SHGs sponsored by Gujarat Livelihood Promotion Company (GLPC) an entity promoted by the Rural Development Department, Government of Gujarat. Sakhi Mandals apart from being exclusive women SHGs are different from other SHGs in only one perspective that is they are sponsored by the state government and its entire movement is led by the official state machinery. Main objective of Sakhi Mandal scheme is to cover all poor women in rural areas of Gujarat with institutional finance through SHGs who were hitherto not covered by other SHGs and provide credit link to them.

6.3.2. SHGs- Commercial Banks Link

In comparison with other states where microfinance sector is doing very well, viz., Andhra Pradesh, Kerala and West Bengal, the sector in Gujarat received momentum with a delay and SEWA was the only major player. As at end-March 2001 Gujarat had only 1429 SHGs with credit linkage to commercial banks as against 71195 credit linked SHGs at all India level, which is about 2 per cent of total. During the same period credit outstanding to SHGs in Gujarat was Rs. 300 lakh as against Rs. 15000 lakh at all India level, barely 2 per cent. 17

1.State Level Bankers’ Committee (SLBC) Gujarat,2001
<table>
<thead>
<tr>
<th>Year</th>
<th>No. of SHGs</th>
<th>No of Members</th>
<th>Amount of savings in Rs. Lakh</th>
<th>Amount of loan In Rs Lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>38668</td>
<td>406184</td>
<td>3141</td>
<td>1589</td>
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<tr>
<td>2005</td>
<td>46675</td>
<td>544217</td>
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<td>3097</td>
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<tr>
<td>2006</td>
<td>61024</td>
<td>683513</td>
<td>7480</td>
<td>5005</td>
</tr>
<tr>
<td>2007</td>
<td>72808</td>
<td>757382</td>
<td>6115</td>
<td>7073</td>
</tr>
<tr>
<td>2008</td>
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<td>14163</td>
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<tr>
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<td>25001</td>
<td>18862</td>
</tr>
<tr>
<td>2011</td>
<td>168991</td>
<td>1851400</td>
<td>24996</td>
<td>22684</td>
</tr>
</tbody>
</table>

(Source: Data for various years compiled from SLBC Gujarat)

The table above highlights the growth of Commercial banks linked SHGs in Gujarat. It can be seen from the table that during 2004-2011, Commercial banks linked SHGs in Gujarat witnessed an impressive growth. Total number of SHGs, at end March 2011 in Gujarat increased to 168991 as against to 38668 as at end-March 2004. Membership of SHGs also increased to 1851400 from 406184 during the same period, which indicates an annual growth of 24.2 per cent per annum. It can be seen that total amount of savings during the same period has increased from Rs 3141 lakhs to Rs 24996 lakhs which indicates an annual growth of 35 per cent per annum. Similarly the total amount of loans during the same period has increased from Rs 1589 lakhs to Rs 22684 lakhs which indicates an annual growth of 46 per cent per annum.

Although, growth of savings and credit to SHGs looks very impressive a caution is wary. The share of both deposits and credit of SHG in the total deposit and credit of the commercial banks in the state is meager. As at end
March 2011, share of bank credit to SHGs in Gujarat was only 0.15 per cent of total credit outstanding of commercial banking system in Gujarat. It was 0.40 percent and 2.45 per cent of credit to priority sector and credit to weaker sections, respectively. However, silver lining is that this share is increasing consistently. As at end March 2004, share of SHGs in total credit outstanding, credit to priority sector and credit to weaker sections in Gujarat by commercial banks was 0.06 per cent, 0.17 per cent and 1.00 per cent, respectively.

Bank credit per SHG is an important indicator of the support extended by the banking system to weaker section.

(Chart 6.2: Bank Credit per SHG)

(Source: Data for various years compiled from SLBC Gujarat)

Chart 6.2 indicates that credit per SHG in Gujarat by the commercial banks increasing up to 2009 but after that it witnessed a sudden decline. As against to Rs. 76765 per SHG it declined to Rs.35367 only. This is a very disconcerting development and needs to be probed thoroughly .It seems that global slowdown had made banks more conservative.
According to the Reserve Bank of India's master circular on SHG-Bank linkage programme, lending to SHGs is linked to their savings. Saving to loan ratio may vary between 1:1 to 1:4. According to guidelines in case of matured SHGs banks may lend more as per their discretion.

Chart 6.3: Advances to SHGs as multiples of Savings of SHGs

(Source: Data for various years compiled from SLBC Gujarat)

As the above chart depicts in Gujarat savings-loan ratio of SHG has varied between 0.73 to 1.76. During March 2011, it was only 1.14 for SHGs. Savings-loan ratio of SHGs in Gujarat is one of the lowest in India. It indicates that banks should increase their lending to this sector. Besides, it is to be noted here that banks do not give loan for consumption or emergency purpose but only for production purpose. They should find out innovative ways to increase their outreach to the poor, as their lending to SHGs is quite less compared to permissible limit of credit by RBI.

Besides, it cannot be negated that many SHG members may not be really poor and some members may be part of more than one SHG also, which may

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lead to double counting of members. If so then real penetration of commercial banks in the segment may decline further.

6.3.3. New Policy Initiatives

Recently the state government and banking sector have taken some initiatives to increase the outreach of microfinance in general and microcredit in particular among the poor of Gujarat. During Vibrant Gujarat Summit 2011, the state government promoted entity Gujarat Livelihood Promotion Company entered into memorandum of understanding with State Level Bankers Committee (SLBC). According to it, banks will provide a minimum credit linkage of Rs. 50000 as cash credit to each SHG/ Sakhi Mandal as soon as it passes grading on completion of six months. This MoU has also reiterated to streamline the entire process through simplified and uniform documents and standardised processes for grading and linkage.

6.3.4. Conclusion and Way Forward

Above analysis indicates that SHG-Commercial Bank linkage model in Gujarat is working successfully and there is huge scope to work further. However, credit per SHG in state is one of lowest in India and most disconcerting is the low savings-loan ratio in the state which needs to be corrected immediately. Although the state government has signed a memorandum of understanding with SLBC to increase the credit linkage to SHGs it would be interesting see whether it increases or not. As such microfinance goes beyond loan and savings and incorporates micro pension and micro insurance, too and other products as well; commercial banks in Gujarat as of now are providing only loan and savings products.

It is surprising to note that not a single private sector bank is providing microfinance services in Gujarat. When commercial banks were consulted for knowing their attitude toward microfinance, the major reluctance they expressed towards indulging much in this field is that though microfinance is
considered a risky venture and MFIs are allowed to charge market determined interest rates, commercial banks can not charge more than its Prime Lending Rate which at maximum can be 12% per annum. The concern of the banks seems to be valid and some consensus must be reached between them and the government because the commercial banks are the most reliable of all the players and they have huge resources and their potential must be harnessed by creating conducive environment.

Hence, in Gujarat SHG-Commercial Bank linkage is working only to a limited extent. Although credit to SHGs from commercial banks is increasing its volume is quite less compared to permissible limit allowed by RBI. Thus, it can be inferred that MFIs and commercial bank linkage serves only to a limited extent as a toll of overcoming problem of poverty alleviation. The overall conclusions of the study are present in the ensuing chapter.