CHAPTER – 2
CONCEPTUAL FRAMEWORK

2.1 Introduction
Prahalad C. K. (2006) in his famous book ‘Fortune at the bottom of the pyramid’ illustrated the assumption behind the dominant logic of commercial organizations. The dominant assumptions are: the poor cannot afford the product and services and the market of poor are not critical for long-term growth and vitality. Prahalad eliminate the first assumption by providing information about poverty penalty, which shows that poor actually paid more money for the same service than relatively rich people. The same logic was explained by micro-finance Yunus M. (2007b) in his famous book titled ‘Banker to the Poor’ stating that banks have designated a class of people as ‘not creditworthy’ (those who do not have collateral) and in reality the repayment of loans by people who borrow without collateral is much better than whose borrowings are secured by enormous assets. The reason is that the poor know this is the only opportunity they have to break out of their poverty and if they fail to repay the loan, they will lose the surviving opportunity. On the other hand, people who are well off don’t care what the law will do to them because they know how to manipulate it. Thirty six years ago, a group of development entrepreneurs created a new strategy for changing global poverty scenario by providing small, uncollateralized loans to forty-two people in a less developed country. The results were surprising and it was found that people started come out of poverty. The movement got momentum when the United Nations General Assembly adopted 2005 as the International Year of Micro-credit to “address the constraints that exclude people from full participation in the financial sector.”

2.2 Concept of Micro-finance
It is rightly pointed out by Khawari A. (2004) although there is a lot of literature on micro-finance, there is hardly any agreement on a universally accepted definition of micro-finance. The differences in opinions of researchers and micro-finance visionaries are found in terms of the scope, target audience and objective of micro-finance. It also varies from country to country.
2.2.1 Micro-finance: An International Experience

The International Labor Organization (ILO) defines micro-finance as “an economic development approach that involves providing financial services through institutions to low income clients.” The definition conceptualizes micro-finance as ‘financial services’ and loosely identifies the target audience in terms of ‘low income clients’ and thus remain silent in terms of level of income. However, one can find specificity in terms of target audience and scope of micro-finance in the definition given by Marguerite S Robinson as cited by Srinivasan R. and Sriram M. S. in their conceptual paper on micro-finance (2003), “micro-finance refers to small scale financial services – primarily credit and savings services – provided to people who farm or fish or herd; operate small enterprises or micro-enterprises where goods are produced, recycled, repaired or sold; who provide services who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals or machinery and tool; and to other individuals and local groups at the local levels of developing countries both rural and urban.” Thus, micro-finance is a type of financial services which mainly include credit and savings on a small scale targeted at individuals and groups that operate at local levels especially in developing countries.

However, the terms ‘micro-credit’ and ‘micro-finance’ are often used synonymously. Yunus M. (2005a), the founder of Grameen bank, also argued that it is creating a lot of misunderstanding and confusion in the discussion and we should discontinue using the term ‘micro-credit’ or ‘micro-finance’ identifying its category. Elahi K. Q and Rahman M. L. (2003), further analyzed the usage of these two terms i.e. ‘micro-credit’ and ‘micro-finance’ and differentiated the same in terms of (a) profit motives and (b) the means of operation. Accordingly, by definition, the micro-credit programmes are NGOs, for which they cannot run their operations with the objective of making profit and depend upon external financing. The micro-finance, on the other hand, is a profit making private venture, which must aim at operating its activities without external help, because profit making and public objective do not go hand in hand. In the same way, Armendáriz B. and Morduch J. (2007), in their famous book titled ‘The Economics of Micro-finance’ emphasized that small difference in words ‘micro-credit’ and ‘micro-finance’, in language signals, for some, a big difference in opinion and argued that ‘micro-credit’, in initial phase, refers to institutions like Grameen bank that were providing loans to very poor with the objective of poverty reduction and NGOs as key players since then it has converted gradually into micro-finance. With the change in language has come a change in orientation toward ‘less poor’ and also in institutions from NGOs to

2.2.2 Micro-finance: An Indian Context

Conceptualizing micro-finance in Indian context again is a difficult task. As argued by Sriram M. S. and Upadhyayula R. S. (2002), micro-finance in India, is generally understood but not clearly defined. Micro-finance is conceptualized as the activity which is provided by the alternate sector (NGOs) with a laudable intention and non-exploitative connotations. However, the reason for the above mentioned attribute of micro-finance is explained by Thorat Y. S. P. (2005), Managing Director, NABARD that it is due to our banking system which has failed to internalize lending to the poor as a viable activity but only as a social obligation – something that had to be done because authorities wanted it so. Further it was translated into banking language of the day: Loans to the poor were part of social sector lending and not commercial lending; the poor were not borrowers, they were beneficiaries; poor beneficiaries did not avail of loans they availed of assistance.

According to Dasgupta R. (2005), micro-finance is a financial service of small quantity provided by financial institutions (FI) to the poor. These financial services may include savings, credit, insurance, leasing, money transfer, equity transaction, etc, that is, any type of financial service, provided to customers to meet their normal financial needs: life cycle, economic opportunity and emergency with the only qualification that (i) transaction value is small and (ii) customers are poor. The Task force of National Bank for Agricultural and Rural Development (NABARD, 2000) defines as “the provision of thrift, credit card and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas enabling them to raise their income levels and improve living standards.” Further the Task Force emphasizes on the following issues at the time of defining micro-finance services:

- Micro-finance covers not only consumption and production loans, but also include other credit needs such as housing and shelter improvement, while other financial services like savings and insurance are also included under it.
• It may be left to the Micro-finance Institutions (MFIs) to identify the poor. However, the selection criterion so adopted will have to be in conformity with the poverty line adopted by the Government of India.

• Micro-finance is very often accompanied by non-financial and other business services like capacity building, forward and backward linkages, etc., provided either by the same or by some other institutions, mainly for enhancing the productivity of credit.

• Micro-finance may (but not necessarily) cover programmes implemented by governments, both directly or through various agencies as also programmes implemented by banks, NGOs, cooperatives, etc., provided that the components of mF as explained above are adhered to.

• While exclusively covering the poor, micro-finance emphasizes on graduating the borrowers from the pre-micro-enterprise stage to the post-micro-enterprise stage with the support of financial and non-financial services.

• The emphasis of support under micro-finance is, therefore, on building up capacities to handle larger resources rather than on financing micro-enterprises which could be otherwise covered by the direct lending programmes of banks or through specific poverty alleviation programmes of the government.

• While the Task Force would not want to indicate any specific limit for "small amount" of financial services under micro-finance, it would emphasize that the micro-finance services and products need to be dynamic to take care of the emerging requirements of the poor under pre-micro-enterprise stage.

2.2.3 What is new in Micro-finance?
As mentioned by Dasgupta R. (2005), micro-credit is not a new concept in India. Priority sector credit in general and weaker section credit in particular was actually a kind of microcredit. What is new in microfinance is perceived as a paradigm shift in the quality of micro-finance delivery. The old paradigm of microfinance envisaged providing credit to poor people basically residing in rural and semi-urban areas at subsidized rates of interest through public or government financial institutions with donor support in general. The new microfinance continues to target the rural and urban poor households, with emphasis on women borrowers, provision of finance for creation of assets and their maintenance, bringing in greater quality to the services and is seen as a significant departure from earlier exercises in providing credit to the poor through financial
institutions, which are often public, at subsidized rates with high default rates (Kaladhar. K, 1997).

2.3 Micro-finance Institutions – Minimalist & Integrated Approach

MFIs by definition provide financial services. However, an MFI may also offer other services as a means of improving the ability of its clients to utilize financial services. There is much debate in the field of micro-finance as to whether MFIs should be minimalist – that is offering only financial intermediation – or integrated – offering both financial intermediation and other services.

Within financial system there are four broad categories of services that may be provided to micro-finance clients:

- **Financial Intermediation** or the provision of financial products and services such as savings, credit, insurance, credit cards, and payment systems. Financial intermediation should not acquire ongoing subsidies.
- **Social Intermediation** or the process of building the human and social capital required sustainable financial intermediation for the poor. Social intermediation may require subsidies for a longer period than financial intermediation, but eventually subsidies should be eliminated.
- **Enterprise development services**, or non financial services that assist micro-entrepreneurs. They include business training, marketing and technology services, skills development and subsector analysis. Enterprise services may or may not require subsidies, depending on the willingness and ability of clients to pay for these services.
- **Social Services** or non-financial services that focus on improving the well-being of micro-entrepreneurs. They include health, nutrition, education and literacy training. Social services are likely to require ongoing subsidies, which are often provided by the state or through donors supporting NGOs.

MFI using the minimalist approach normally offer only financial intermediation, but they may occasionally offer limited social intermediation services. Minimalists base their approach on the premise that there is a single “missing piece” for enterprise growth, usually considered to be the lack of affordable, accessible short-term credit, which the MFI, can offer. While other “missing pieces” may exist, the MFI recognizes its comparative advantage in providing only financial intermediation.
Other organizations are assumed to provide other financial services demanded by the target clients. This approach offers cost advantages for the MFI and allows it to maintain a clear focus, since it develops and provides one service to clients.

The integrated approach takes a more holistic view of the client. It provides a combination or range of financial and social intermedation, enterprise development, and social services. While it may not provide all four, the MFI takes advantage of its proximity to clients and based on its objectives, provides those services that it feels are most needed or that it has a
comparative advantage in providing. As the majority of MFIs focus on financial intermediation; it has been discussed in detail.

2.3.1 Financial Intermediation (Micro-finance as bundle of Financial Services)

The primary role of MFIs is to provide financial intermediation. This involves the transfer of capital or liquidity from those who have excess at a particular time to those who are short at that same time. The range of products that commonly provided includes following:

2.3.1.1 Micro-credit

Loans are generally made for productive purposes – that is, to generate revenue within a business. Some MFIs also make loans for consumption, housing or specific occasions. While many MFIs insist that only productive loans be made, any loan that increases the liquidity of the household frees up enterprise revenue, which can be put back into business. Many MFIs and pioneer micro-finance providers like Self-Employed Women’s Association (SEWA) Bank have found that they need to begin by providing credit to meet mainly the consumption needs of their clients which helps in reducing the importance of local money-lenders and instilling a sense of security among them. Subsequently, MFIs offer credit services to the clients for undertaking various income generating activities.

Methods of credit delivery can generally divided into the two broad categories of individual and group approaches; based on how the MFI delivers and guarantees its loans. Individual loans are delivered to individuals based on their ability to provide the MFI with assurances of repayment and some level of security.

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- Individual loans are delivered to individuals based on their ability to provide the MFI with assurance of repayment and some level of security.
- Group based approaches make loans to groups – that is, either to individuals who are members of a group and guarantee each other’s loans or groups that then sub-loan to their members.

2.3.1.2 Micro-savings

There are deposit services that allow one to save small amounts of money for future use. Often without minimum balance requirement, these savings accounts allow households to save in order to meet unexpected and plan for future investments.
2.3.1.3 Micro-insurance
It is a system by which people, business and other organizations make a payment to share risk. Access to insurance enables entrepreneurs to concentrate more on developing their business while mitigating other risks affecting property, health or the ability to work.

2.3.1.4 Remittances
There are transfers of funds from people in one place to people in another, usually across borders to family and friends. Compared with other sources of capital that can fluctuate depending on the political or economic climate, remittances are relatively steady sources of funds.

2.4 Microfinance Institutions: Legal Form
There doesn’t exist any unique legal framework for MFIs in India. MFIs in India mainly follow one of the four structures viz. charitable institutions, Co-operatives, Companies and Banking Institutions.

2.4.1 MFIs as Charitable Institutions
There are societies registered under Societies Registration Act, 1860 and Trust under the Trust Act, 1882. They work on grants. They are not able to handle funds of SHGs or act as an intermediary beyond a level. They are not allowed to raise equity and mobilize deposits. These structural restrictions limit the availability of capital to these MFIs. Often these, institutions are found to survive on foreign grants.

2.4.2 MFIs as Co-operatives
Co-operatives have legal sanction to work as financial intermediaries. The activities of co-operatives are restricted in state. Their activities are heavily controlled by the controlling authority, Registrar of the Cooperative societies and the state government. Co-operatives are allowed to raise share, to mobilize deposits. No tax is charged on co-operatives. They can get foreign debt but are not allowed to raise foreign equity.

2.4.3 MFIs as Companies
MFIs have to have ₹2 crore as its initial funds if these are operating as Non Banking Financing Companies (NBFC). These are required to obtain a registration certificate from RBI (under section 45-I A of the RBI Act) after satisfying initial conditions. They are allowed to mobilize deposits after satisfying conditions stipulated by RBI. After two years of their operations, they have to obtain minimum investment grade or other specified credit rating for fixed deposit from any specified rating agencies at least a year. They are then
required to forward it to the RBI along with the annual returns. They are allowed to collect foreign equity up to 51% of US $ 0.5 million; more than 51% to 75% of US $ 5 million and 100% of US $ 50 million.

2.4.4 MFIs as Banking Institutions

The MFIs who are operating as banks are registered under RBI but it is very difficult to obtain this registration. To set up MFI as a bank it would require initial capital from ₹100 to ₹300 crore. For Local Area Bank the amount is ₹5 crore. Local Area Banks are permitted to operate on three contiguous districts in a state. These are also highly management and technology intensive to achieve sustainability. These MFIs are permitted to deliver credit, to mobilize savings and to give insurance (under the regulation of IRDA).

2.5 Micro-Finance Delivery Models in India

There exists a wide range of micro-finance delivery models in India. It can be said that India hosts the maximum number of microfinance channels. MFIs in India have adopted various traditional as well as innovative approaches for increasing the credit flow to the un-organized sector. They can be categorized into four broad categories:

2.5.1 Self-Help Group Model

SHG has emerged as an “Indian Model of Micro-Finance”. The SHG model, like almost all the other models in Microfinance, has evolved in the NGO sector. Self Help Groups are small (membership 10 to 20), informal groups that have socially and economically homogeneous membership of poor people drawn from the same hamlet or from nearby hamlets. The composition is mostly male only or female only (as of now in India more than 90% of the SHGs are female only). The members are self-selected, meaning the potential members have a choice of being in this group or that group depending on their level of affinity with the other potential members. Thus the basic design of the SHG is robust and makes it easy for the NGO facilitator to build it into a strong social and financial institution.

Once the basic group is identified the NGO facilitator builds in processes and systems that make the SHG a viable, sustainable institution. The group meets regularly, mostly weekly, at an appointed time and place and carries out its financial transactions of savings and credit. The group mobilizes savings among its members (only) and makes need based loans to the members (only) out of the pool of funds created. The rules and norms of the group are determined by the group members themselves and the NGO facilitator does not impose anything. The facilitator helps in designing and installing systems for the transactions,
conducted meeting, resolving conflicts and for networking. Thus while the SHG provides the members with financial services, the NGO provides them with the support services, training, system setting and in developing linkages.

The internal transactions are strengthened first, and subsequently the groups are linked with banks for supplementary financial assistance. At this juncture the NGO also provides the group with training for income generation activities and also assistance in forward and backward linkages.

Roughly, the group promotion process through its various stages beginning identification of members to linkages with viable income generation programmes can take anything from 3 to 5 years depending on the NGO and the area. After the SHG has been put on the path to sustainability, organizationally and financially, the NGO may decide to withdraw from supporting the SHG and move on to new groups.

As said earlier, the NGOs promoting SHGs have set out with a broad vision of development, which culminates in the empowerment of the poor both socially and economically, therefore the activities taken up with the SHGs also reflect these concerns. Therefore we have a phenomenally large number of women’s SHGs that have been promoted and the SHGs also take up social and political issues in addition to livelihoods. The compatibility of the SHG to adapt itself to the wide variety of developmental concerns and approaches, have made it currently the most popular model also.

The SHG derives it’s strength from the fact that it provides an avenue for the poor to save and take small credit as and when needed. And this forms the primary stake that the member develops in the group. The fact that the members are all from the same settlement and know each other very well helps the members exert peer pressure on each other, in case of errant behaviour. This peer pressure ensures that the members follow the group norms strictly. The facility that the SHGs have now of drawing finance from the mainstream makes it more attractive because even bigger loans are now possible.

Features

- The group promotion process is a long one, the poor have to wait considerable amounts of time, before they can start availing loans of reasonable amounts.
- The amounts available in the beginning are very small, and all the members cannot take loans at a time.
• The functioning of the group relies totally on group dynamics, peer pressure, etc. These are very difficult to build in and call for very high order of facilitation that every NGO may not have access to.

• Conflicts arise on seemingly trivial reasons, which would lead to a total group break down. It is very difficult to rebuild a group that has broken once.

• The exclusively women’s groups face a disadvantage of the interference of the male members of the village leading to group break down.

• The SHG model has evolved in NGO sector. NGOs primarily have the functions of enabling, educating and networking. This model has emerged as the capacity building of community based institutions.

• SHGs are small and informal groups (strength of group members – 10 to 20). Group members are socially homogeneous.

• Groups are composed either by male or female only. In India 90% of the SHGs are composed of male only.

• Group members are self-selected. NGO acts as a facilitating agency to build in processes and system that make the SHGs viable and sustainable institutions.

• The group members meet regularly at an appoint time and place for carrying out their savings and credit activities and other issues of development.

• The group mobilizes savings among the members and issues need based loans to members (only) out of the common funds created.

• The rules and norms are determined by members themselves and NGOs doesn’t interfere in this manner.

2.5.2 Federated SHG

Federations of SHGs bring together several SHGs. In India, the Dhan Foundation, PRADAN, Chaitanya and SEWA are famous in promotion of federated SHGs.

Features

• Federations usually come under the Societies Registration Act. They have between 1000-3000 members.

• There is a distinct three-tier structure in federations – the SHG is the basic unit; the cluster is the intermediate unit an apex body or a federation, represents the entire membership.
• Each SHG participates directly in the representative body at cluster level. Two members from each SHG attend the monthly cluster meetings. Information from the groups to the apex body and vice-versa is channeled through the cluster representative body.

• The cluster leaders are a highly effective part for group monitoring and strengthening. So the operations of the apex body are decentralized through clusters.

• The executive body at the apex level consists of 9 to 15 members.

• Three common financial activities of federations are:
  - Acting as an agent and manager of external credit funds.
  - Assisting SHGs with loan recovery in difficult cases.
  - Strengthening weak SHGs, so that they are able to carry out their savings and credit functions smoothly.

2.5.3 Grameen Bank Model
The Grameen bank model of Bangladesh developed by Mohammad Yunus, its former chairman was considered as pioneer microfinance institution. It has been highly successful in its banking service to the poor as well as in poverty alleviation programmes. With its well organized success, many organizations in India, like SHARE Micro-Finance Ltd. Activities for Social Alternative (ASA) and CASHPOR Financial and Technical Services Ltd. have adopted this methodology with little variations.

Features
• Homogenous groups of five members are formed at village level.
• The field workers of Grameen Bank facilitate the process of group formation.
• All the group members undergo a 7 day compulsory training of 1-2 hours per day. Some groups undergo the Group Recognition Test (GRT). It is a screening test that can distinguish between serious and non serious group.
• Once preliminary groups have passed GRT, and then the women become members of Grameen Bank by paying a one time member fee.
• Eight joint liable groups affiliate together to form a center. Every week centre meets at a defined time. Bank Assistant attends the meeting and it is mandatory for members to attend the weekly meeting and all the loan applications have to be approve by the group members as well as centre members. The loan is disbursed from the bank fund.
and it is not linked with the group savings. Loan is given to the individual not the group or the center.

- Loans are provided for all kinds of the major categories of loans-General Loans, Supplementary loans, special general loans, Sanitation and housing Loans.

- The savings are compulsory for the members. Every member saves Tk.10 every week. This amount is deposited with Bank. With this deposit the Bank funds their consumption needs. This strategy has paid off, because members are less likely to default on their own money as opposed to when funds are provided by outside institutions.

- The size of the loan generally ranges from ₹4000 to ₹10,000 for general yearly loans. The first year size is ₹4000 and there is an annual increase of ₹1000 in loan size, for every year thereafter. All loans including agriculture loans are repayable within a year (52) equal instalments spread over 52 weeks.

- The provision of 5% tax of all productive loans disbursed to a member is one of the most important strategies to increase group fund. This fund remains with the group. From this fund the members can access the loans for consumption purposes. The belief here is that, if there is an alternatives provision for consumption loans, then the clients will not divert production loans to meet their consumption needs.

- The group leader collects the loan repayments and savings prior to the meeting and hands it over to the Centre leader who in turn during the meeting gives it to the field worker. The collected money is never used for fresh loans. It is deposited in the branch the same day. In a sense it is a good practice as it discourages all possible leakages in monetary transactions.

- The interest rates are nominal, mostly charged on flat basis. It varies from 15-24%.

- Collateral is replaced by Peer Pressure. The incentive to timely repayment is repeat loans and continuous access to increasing credit from Bank. There is a provision of loan utilization check. The field worker with the help of group members mainly does this.

Some of the significant elements of this methodology are:

- Low Transaction Cost- peer Appraisal
- No collateral- Peer Pressure
- All kind of Loans- productive and Consumption
- Repayment in small, regular and short intervals
- Quick loan sanction- not much formalities, paper work

The most remarkable aspect of the Grameen bank’s has been its high loan recovery rate, in the range of 98% and above. This has contributed to the bank having a low cost of credit and has attracted low cost of funds from the government and international donors.

While the Grameen model is limited to less than a dozen major NGO- MFIs or NBFCs, it is an important alternative credit delivery system to mainstream finance. Some of the comparative strengths and weakness of the Grameen approach vis-à-vis SHGs are given in a later section.

2.5.4 Co-operative Model

The leading organization that has been successful in using the cooperative form in rural microfinance in India has been the Cooperative Development Forum (CDF), Hyderabad. CDF’s approach has relied on a credit union model involving a savings first strategy. It has built up a network of financial cooperatives based upon women’s and men’s thrift groups.

After lobbying successfully for an enabling legislation in the State of Andhra Pradesh for the flexible functioning of cooperatives (which result in the Andhra Pradesh Mutually-Aided Societies Act), it has registered the associations of thrift groups promoted by it under this Act.

**Features**

- The primary entities of CDF’s Micro Finance Cooperative are the Women’s / Men’s Thrift Cooperative (W (M) TC). Each consists of 300 members. Generally these members reside in the same village.
- CDF has started to promote much smaller units and now it has encouraged these units to extend into large unit.
- The important factors behind the running of a successful cooperative venture are: a) to justify human resources (staffs); b) to meet statutory / administrative requirements such as audit.
- The WTC or MTC are divided into small groups (10 to 50 members) to facilitate better monitoring of thrift and repayment of loans.
- The group members nominate a group leader and the leader enjoys the confidence of the group.
CDF encouraged members to identify more strongly with their WTC/MTC rather than with the groups, as WTC/MTC are the primary legal entities and viable units of operation.

Most of the WTC/MTCs decided to register themselves under the New Generation Cooperative Act, which allows for greater flexibility and autonomy in operations.

The General Body constitutes of all the members of the primary cooperatives. It adopts a uniform set of bylaws. The General Body meets once in a year to elect the directors, review and discuss the other issues. The Board of Directors consists of 12 directors who are elected by the members.
References


Websites

www.nabard.org

www.oneworldaction.org