ORIGIN OF MICROFINANCE IN INDIA

The origin of microfinance is quite absorbing. Microfinance combines the strengths of both formal and informal systems of purveying credit. Availability of hassle free credit in a systematic manner is the unique feature of microfinance system. Microfinance in informal system was in vogue in India in the form of chit funds, etc., since time immemorial. It came into existence under formal system with the advent of cooperative movement in India in the beginning of the last century. The microfinance is primarily based on the principles of co-operation namely, mutual help, democratic functioning etc. Though, the co-operative movement was initially envisaged with unlimited liability and small size of societies consisting of homogenous groups, over the years in the quest for improving the viability of co-operatives, large societies with limited liabilities were organized. This apart, the evolution of State partnership in co-operatives with entrenched bureaucracy etc., distanced co-operative movement from the spirit of microfinance movement.

POLICY FRAMEWORK

In the Indian context, the interventions of voluntary agencies in the socio-economic development of masses can be traced back to pre-independence days. Owing to the inability of formal financial system to reach the poor due to lack of collaterals, asymmetric information and high
transaction costs, a number of voluntary agencies / NGOs entered the domain of rural credit for organizing the poor into informal groups for mutual economic and social empowerment. However, the origin of microfinance movement in its present shape dates back to 1986, when the Sixth General Assembly of APRACA at Kathmandu in Nepal considered a proposal for promotion of linkages between formal institutions and Self-Help Groups. As a sequel to it, in India, the National Bank for Agriculture and Rural Development (NABARD) in consultation with Reserve Bank of India organized workshops and national consultations and ultimately launched a pilot project in 1992 for linking 500 Self-help Groups with commercial banks i.e. the formal sector. The pilot project was further extended to Regional Rural Banks and

Co-operative Banks in 1993.

It is in this context that there is a growing interest in alternative credit delivery mechanisms like microfinance programs. In the delivery of small loans to the poor (micro-credit) there are five distinct approaches: In India the National Bank for Rural Development (NABARD) and the Reserve Bank of India (RBI) has actively promoted it by providing increasing funding to microfinance institutions (MFIs). Under the NABARD’s Self-Help Group (SHG) – Bank linkage model (which is different from the Grameen Bank Model), SHGs bring together about 10-20 women who pool their savings for a few months, allocate them to members who need small amounts temporarily, thus making them eligible for a bank loan. In India, micro-credit is provided through (a) Bank-led model (Bank-SHG linkage model) of delivery as well as through (b)
Commercial model\textsuperscript{35}. The commercial model is based on funding of microfinance institutions (MFIs) which comprise of Non Government organizations (NGOs), non-banking financial institutions (NBFCs), charities and cooperatives (like SEWA in Gujarat). In the commercial model, there are two variants: (1) Bank-MFI model and (2) Partnership Model pioneered by ICICI bank. The SHG-Bank linkage model was introduced in 1991-92 with a pilot project of linking 500 SHGs with banks which increased to more than 16 lakh by the end of March 2005. Cumulatively, these SHGs have accessed credit of Rs. 6,898 crore from banks during the period. About 2.4 crore poor households have gained access to the formal banking system through the programme. During the last six years the number of SHGs linked to banks has gone up from 32,995 during 1998-99 to 16,18,476 during 2004-05.

In India, increasing credit access to the poor through financial inclusion is a crucial component of the Indian economic planning and fight against poverty. The nationalization of major banks in 1969 and mandated directed credit programme to the priority sector since the early 1970s was part of the push for financial deepening and inclusion. But the economic reforms since 1992 with emphasis on deregulation and efficiency had a profound impact on the financial landscape especially the access of credit to the poor. Studies have shown that access of rural households to institutional sources of finance has declined since 1992 and the share of debt of rural households especially from non-institutional sources has increased. In India, the promotion of the microfinance delivery through Bank-Self-help Group (SHG) model by the Reserve Bank of India and

National Bank for Agriculture and Rural Development (NABARD) since 1992 is to replace the state activism of the 1970s and 1980s by private sector (microfinance) entities to promote financial inclusion. After a series of farmers' suicides in the country, which are linked to rising indebtedness, all banks are being urged to adopt ‘financial inclusion’ as an operational policy.

Although, the outreach of microfinance in India has increased from a modest 33 thousand SHGs 1992 to 2.9 million SHGs by 2007, the biggest driver of this expansion – the commercial model (based on profits) received some setbacks in March 2006 with borrowers in the state of Andhra Pradesh (with the highest microfinance density in India) showing considerable hostility to these entities on the ground that they behave like loan sharks. It is in this background there is a search for alternative delivery models of microfinance.

THEORETICAL FRAMEWORK & BACKGROUND

Traditional efforts by Non Government organizations (NGOs) may reach poor clients, but are often unsustainable. Microfinance on the other hand, combines both outreach and sustainability. Such practice is perhaps most clearly embodied in the microfinance, which marries the best of the formal financial sector in terms of sustainability with outreach to poor clients of the development NGO.

Since independence, the Government of India in general and Reserve Bank of India in particular have made concerted efforts to provide the poor access to credit. However, the limited success of co-operatives forged the need for nationalization of commercial banks and later on establishment of
Regional Rural Banks, which have mandated credit programmes for the low income households. Despite the phenomenal physical outreach of the formal credit institutions achieved in the past several decades, the rural poor continue to depend on informal sources of credit on account of the cumbersome procedures associated with formal credit. The credit needs are small, frequent, and usually emergent and they arise at unpredictable times. For the poor, the consumptive credit needs often precede and also determine their productivity.

For various reasons, the credit flow to the poor for meeting all their requirements did not get institutionalized. Some of the major causes lie in the difficulties in dealing effectively with a large number of small borrowers, who require credit as said earlier, frequently and in small sums, and also the banks’ perceptions of the risk and creditworthiness of these borrowers. To address these problems effectively the microfinance has been tried as a viable alternative in reaching the hitherto unreached and fills up the gap in the demand and supply. Microfinance is not financial intervention alone. It is a holistic approach covering social intermediation along with a provision of financial services needed by the poor such as thrift, credit and insurance.

Credit under microfinance programme is extended on the basis of social collaterals in the form of joint liability with or without Self-Help Group. Credit intervention is based on the past performance of the borrower with gradual increase in subsequent doses of credit. In short, microfinance is the cutting edge of the development of the poor.
STRENGTHS OF INDIAN MICROFINANCE SECTOR

India is the largest democracy in the world. Unity in diversity is the greatest strength of India. Despite vast differences in terms of language, caste, religion, etc. driven by the co-operative spirit, people are interwoven with common affiliations and social obligations. The factors like personal rapport and proximity and like mindedness have added to the spread of the programme. Many SHGs have come into existence in India spontaneously and have exhibited tremendous democratic functioning and group dynamism. Their adroitness in assessing and appraising the credit needs of members, their business like functioning and efficiency in recycling the funds often with repayment rates nearing cent percent are additional positive features. Some of the best practices followed under microfinance sector in India include inter alia:

1. Broad based definition of microfinance.
2. Adoption of multi model approach.
3. Greater freedom to microfinance institutions.
5. The use of computers in microfinance and
6. Certain other important best practices.

These aspects have been discussed in greater details in the following paragraphs.

**Multi Agency approach** : It has been decided to involve various agencies in mainstreaming and up scaling of micro-finance. All the major credit institutions viz., commercial banks, co-operative banks, regional rural banks have been involved in microfinance programme. Distinct linkage
models are being followed under different arrangements. Under Model-I, banks take up the work of forming and nurturing the groups, opening their saving accounts and providing them bank loans. Up to March 2002, 16 percent of the total numbers of SHGs financed were from this category. Under Model-II, SHGs are formed by NGOs and formal agencies but are directly financed by banks.

**Greater Freedom to the Microfinance Institutions:**

i) RBI has allowed banks to formulate their own models or choose any conduit/intermediary for extending micro credit. Banks are allowed to choose suitable branch / pocket / area where micro credit programmes can be implemented.

ii) Banks are permitted to prescribe their own lending norms keeping in view the ground realities.

iii) Banks are also allowed to devise appropriate loan and saving products and related terms and conditions including the size of loan, unit cost, unit size, maturity period, grace period, margins and purpose of borrowing including for housing and shelter needs.

iv) Interest rates on bank's loans given to microfinance institutions are completely deregulated.

v) Bank lending under microfinance is treated as part of priority sector targets as well as under sub-target of lending to the weaker sections.

vi) The microfinance institutions registered as not for profit NBFCs have been exempted from registration and prudential requirements. RBI has permitted such NBFCs to provide credit not exceeding US $ 0.001 million for business activity and US $ 0.003 million for meeting the cost of a dwelling unit to the poor.
vii) Unsecured advances given by banks to SHGs against group guarantees be excluded for the purpose of computation of the prudential norms on unsecured guarantees and advances until further notice. This apart, the Government of India has also allowed foreign direct investment in micro credit to encourage foreign participation in various microfinance projects.

**Computerization of Microfinance Operations**: Generally, the facilitator tracks member accounts at the village level with hand written sheets and passbooks. A good measure of time is devoted to manually updating the records and little time is spent on interface and discussions on economic and social aspects. Elsewhere in southern part of the country a micro credit institution known as Swayam Krishi Sangam (SKS) has introduced Smart Card into its micro credit programme.

**MICROFINANCE MODELS / APPROACHES IN INDIA**

The following generic approaches to microfinance are commonly prevalent in India:

i. The basic SHG model with Commercial Bank linkage programme.

ii. The Federated SHG approach.

iii. The Rural Industries Promotion (SHG) Framework.

iv. The GRAMEEN Replicator Approach

v. The Urban Co-operative Banking Model

vi. The Multi-State Co-operative Solidarity Group Model

vii. The Enabling Co-operative Networking Framework

viii. The Co-operative - Grameen Hybrid Model

ix. The NBFC Approach
Microfinance through SHG: Phase I: From 1987 to 1992:

During this phase – largely omitted in recent studies – NABARD focused on supporting NGO initiatives to promote SHGs and on analyzing their potential and performance. In 1987 NABARD first put funds into the SHG/SAG movement (in response to a proposal from MYRADA submitted in 1986). In 1987 it provided MYRADA with a grant of 1 million Indian rupees to enable it to invest resources to identify affinity groups, build their capacity and match their savings after a period of 3-6 months. The grant was based on MYRADA’s experience in promoting SHGs since 1985 and the initiative of the NABARD chairperson at that time. As a result of the feedback from this initiative, in 1989 NABARD launched an action research project in which similar grants were provided to other NGOs. After an analysis of this action research, and owing to the efforts of successive NABARD chairpersons and senior management, in 1990 RBI accepted the SHG strategy as an alternative credit model. NABARD (1992) issued guidelines to provide the framework for a strategy that would allow banks to lend directly to SHGs. Based on these initial experiences, the SHG Bank Linkage Programme was launched in 1992 (this second phase is described in Section III). Since then – and on the basis of its extensive network of officers – NABARD has promoted and monitored the SHG programme, provided funds for capacity building and innovation, and helped change policy to create an enabling environment.\(^{36}\)

**SHG Linkage:** Under this programme Microfinance has until now been carried out entirely in terms of disbursements, both annual and cumulative,

\(^{36}\) NABARD (2002), *Annual Report- 2001-02, Mumbai*
rather than loans outstanding at the end of year. The latter is a stock measure of size, as compared to a flow, and provides a better basis for comparison with the size of lending under the MFI model, or with bank lending to other categories of borrowers such as marginal farmers, since it standardizes for loan tenor. In an important study based on a survey of participating banks under the programme conducted by GTZ / NABARD in 2005. These ratios had been the subject of conjecture until now.

**ADVANTAGES OF MICROFINANCE**

Microfinance is argued to have economic, social and humanitarian advantages. This study tends to focus on the economic implications of microfinance, but also outlines social and humanitarian aspects of microfinance in order to better understand the topic.

Many researchers argue that microfinance creates access to three types of capital. First, it gives access to productive capital through microcredit. Second, it gives access to human capital through vocational training and education. And third, social capital built through creating local organization building, promoting democratic systems and fortifying human rights. These endowments together are argued to enable people to move out of poverty. Although it is nearly impossible to measure, increasing material capital strengthens the sense of dignity of poor people and contributes to motivating poor people to participate in the society. With a loan and a source of income people are argued to be able to improve the socio-economic position of their family and to make plans beyond only the survival of the day. The existence of these conditions stimulates people to be actively involved in society. Participation in microfinance programs leads to a greater diversification of labour supply across seasons. On the
contrary, access to these programs goes along with a reduction in the variability of consumption across seasons. Apparently, although the programs might not increase consumption on average, they might offer households opportunities to smooth consumption through smoothing income. For this reason, poor households are argued to become less vulnerable due to microfinance.

In many cultures and countries, the subordination of women still exists. In many cases, men take care of income and money and women take care of basic needs such as health care of their children, education and nutrition and in addition also try to improve the development of those basic needs. Microfinance creates the opportunity for women to get access to capital. Pitt and Khandker\textsuperscript{37} argued that money spent by women leads to an increase of children’s participation in education, better nutrition and health care. Microfinance for women thus is argued to lead to positive external effects on the one hand and to the reduction of gender inequality and dependency on the other hand.

**DISADVANTAGES OF MICROFINANCE**

Microfinance is a much criticized strategy. Many intellectuals doubt that microfinance has any influence on poverty alleviation, disagree with the proposition that microfinance reaches the poorest and don’t think that microfinance will sort any effect on the long term economic impact on SHG\textsuperscript{38}. Reaching the very poorest people is of crucial importance in order to reduce severe poverty. An important point of criticism on microfinance


is that the very poorest can’t be reached with this method; researchers argue that microfinance can be successful for individuals with a low consumption level who can realize a degree of savings. Vulnerable people are not able to level their consumption and are quite sensitive to income shocks, and thus have little advantage with the aid of microfinance. The effect of microfinance on the very poorest and vulnerable people is argued to be very low. In practice a substantial share of a loan will be invested directly by men, while at the same time women maintain responsible for the repayment of the loan. Because women do not invest the money, positive external effects disappear. Microfinance does then not contribute to the reduction of gender inequality and the dependency position of women. Goetz and Gupta conclude that the chance of daughters going to school diminishes when women become independent entrepreneurs. Prominent fact is that the debate about the impact of female empowerment is controversial in the literature. One camp believes that microfinance programs positively contribute to female empowerment. A second, more skeptical, viewpoint believes that microfinance programs do little to alter gender relations in favour of females but in fact may contribute to reinforcing existing gender imbalances\(^\text{39}\). Clearly, the international development community and intellectuals have not reached an agreement yet on the influence of microfinance on poverty alleviation.

**REFORMS IN CO-OPERATIVE SECTOR**

From 1991, the reforms in the banking sector have been initiated in commercial banks, the reform process in co-operatives have taken much

longer time in initiation on account of certain limitations, viz., the need for generating a consensus among the various State Governments which govern and control cooperative credit institutions and the need to balance the interests of very many diversified groups which control, operate and guide the co-operatives. However, despite these limitations, a few major reforms have been introduced in the co-operative credit sector. While examining reforms in the co-operative credit sector, he not only delves into the positive and negative effects of the policy reforms but also suggests some new steps that need to be initiated to truly restructure and bolster the cooperative credit sector in the country. The economic viability and successful and efficient functioning of cooperatives have been the foundation of a generation of economists, especially in the aftermath of the dawn of liberalization era and consequent changes in the economic scenario. Of late, the withdrawal of the Government regulations from many spheres of economic and business activities has enabled the use of cooperatives as an institutional set up for implementing the programmes relating to socio-economic development. The new economic policies are expected to usher in a host of such those favourable conditions as autonomy, freedom with greater accountability and changes in co-operative laws, that will eventually lead to a gradual freeing of the co-operatives. The co-operative sector in the changed economic scenario has better opportunities for expanding and diversifying its business operations relating to farm and non-farm activities in agriculture.

However, some quarters fear that unhindered unleashing of market forces will subject the co-operatives to unequal competition from the private sector with no patronizing support forthcoming from the Government for their growth and development. Nonetheless, experts also concede greater growth opportunities for the non-credit co-operative organizations, especially those which are as large in their size and market reach as any of the private or multinational firms. Microfinance institutions pursue a different vision in the fight against poverty. Their objective is to reduce poverty with the aid of loans. Rather than making transfers to poor households, microfinance programs offer small loans to foster entrepreneurial activities.

There have been many success stories of the poor SHG members showing exemplary entrepreneurial qualities to come out of the vicious circle of poverty and indebtedness with the help of SHGs. The tremendous impact on the social status of the poor rural women becoming bread earners of their households through the instrument of SHGs has been highly commended by many researchers. The impressive performance under SHG-BLP prompted other developmental agencies like the Government Departments to depend heavily on such groups to take the development efforts forward. A large number of service deliveries of the Government Departments are now contracted to SHG members in preference to private contractors largely prompted by their devotion and efficiency.

The journey so far traversed by the Self-help Group – Bank Linkage Programme (SHG-BLP) crossed many milestones – from linking a pilot of 500 SHGs of rural poor two decades ago to cross 8 million groups a year ago. Similarly, from a total savings corpus of a few thousands of Indian
Rupees in the early years to a whopping Rs. 27,000 crore today, from a few crore of bank credit to a credit outstanding of Rs. 40,000 crore and disbursements touching Rs. 20,000 crore during 2012-13. The geographical spread of the movement has also been quite impressive - from an essentially Andhra Pradesh – Karnataka phenomenon in the beginning now spreading to even the most remote corners of India. Over 95 million poor rural households are now part of this world’s largest micro credit initiative. Unlike similar experiments in other developing countries, the SHG-BLP lay emphasis on regular savings by the members with the savings corpus being used to lend among them and as needs arise, later by linking the groups with banks for availing credit. The poor in the country have demonstrated that inspite of being poor, they are, perhaps, the most “bankable” clients and most willing to help each other for a better tomorrow.

There have been many success stories of the poor SHG members showing exemplary entrepreneurial qualities to come out of the vicious circle of poverty and indebtedness with the help of SHGs. The tremendous impact on the social status of the poor rural women becoming bread earners of their households through the instrument of SHGs has been highly commended by many researchers. The impressive performance under SHG-BLP prompted other developmental agencies like the Government Departments to depend heavily on such groups to take the development efforts forward. A large number of service deliveries of the Government Departments are now contracted to SHG members in preference to private contractors largely prompted by their devotion and efficiency.

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41 Extrapolated: 70% goes for internal lending and actual outstanding balance is Rs. 8,200 crore with the banks. 1 crore = 10 million
While all the stakeholders of this highly successful micro credit initiative ride on past glory, there are clear signs of the initial excitement turning into pride and then to complacency. The rapid growth of SHG-BLP also led to more aggressive targets – new set of milestones, often at the cost of quality. When the Government decided to adopt this successful development model for spearheading its poverty alleviation programmes, it had to be a big leap – a leap for which the stakeholders were not fully equipped nor was there enough time to prepare the clients for the transformation. The result was an overall dilution in the basic premise of Self-help and group cohesion to achieve the subsidy targets set by the Government. Group formation is increasingly perceived as a means to have access to Government Subsidies and entitlements and thus have serious implications for the future of the movement. This has also led to cases of multiple memberships by members in SHGs, in select cases. Further, the initial emphasis on graduation of the SHG members through regular savings and internal lendings reinforcing cohesion among the members, before accessing credit from financial institutions in progressive doses, gave away to high doses of credit without waiting for the groups to become cohesive and without linking the quantum with their capacity to utilise and service the loans.

Although SHG-BLP was an attempt to bring the “unbanked” poor into the formal banking system and to inculcate among the poor the thrift and credit habits, a natural corollary is for the group members to graduate into seeking more and better livelihood opportunities with access to credit from formal financial institutions. This particular aspect probably did not get the attention it deserved in the past and the result was, as the aspirations
of the poor members rose, they were not adequately equipped to seek and adopt better livelihood opportunities or becoming entrepreneurs.

A few initiatives by NABARD like demand based skill training and market linkages of SHGs to rural haat have encouraged establishment of micro enterprises by the members of matured SHGs. Even efforts by government programmes like the “Kudumbashree” in Kerala state with the assistance of NABARD commenced a land leasing project by small groups of women in Joint Liability Groups (JLGs). There are over 38000 JLGs in Kerala covering 2.5 lakh women cultivating 24,000 ha of land which forms about 9% of the total current fallow of the state. Thus, government programmes like the “Kudumbashree” have also heralded a new beginning of enterprises through group action.

Though, SHG-BLP is a step towards bringing the “unbanked” poor into the mainstream banking channels, its formal acceptance as a Financial Inclusion (FI) initiative by the Reserve Bank is still awaited. Though several initiatives were taken by the Government of India, the Reserve Bank of India, NABARD and banks to bring the poor into the fold of formal financial service providers, no serious attempt was made to leverage the SHG-BLP to achieve the FI goals. In fact, there is a need for SHG-BLP and FI initiative working in a complimentary manner, synergizing the strengths and ensuring effective banking footprints in remotest of hinterlands. A successful programme like SHG-BLP which could link millions of rural poor to formal banking system could have been the main instrument for financial literacy and FI in the country. There are number of plausible ways by which matured SHGs could have been participants in the FI initiative, including being agents of providing direct banking services to
the poor at their doorsteps, as a low cost and efficient alternative. This model is certainly more cost effective and reliable alternative to the existing inclusion agenda and millions of households, now members of SHG-BLP, would have been the immediate beneficiaries.

The SHG-BLP though made impressive progress during the last two decades of its existence, is at an inquisitive juncture now. For the first time since the programme was launched two decades ago, the number of SHGs linked to Banks showed a decline during 2012-13. Similarly, fresh loans to SHGs have been near stagnant for last few years; though it showed a marginal rise during 2012-13. From an envious record of almost 100% recovery of loans by SHGs, the NPA\textsuperscript{42} of SHG loans by Banks have reached an alarming high of over 7% of the loans outstanding against them. More painful is the fact that loans to SHGs in the most resource poor regions in the country reported NPAs of over 10%.

Further, as indicated, this potent and effective financial inclusion measure, has not received the attention with bankers presently focused on opening individual accounts through BF\text/s/ BC\text{s}. However, the solution lies in reinventing the basic principles on which SHG movement was founded while responding innovatively to financial access and effectiveness through the media of SHGs. The success of SHG-BLP (or FI) will be assessed not on the basis of savings or credit linkage or on social capital leveraged, but on the basis of the improvement in the quality of lives of its members.

Realising the catalyzing role it has played in the growth of SHG-BLP and the need to make the programme more relevant for the future, NABARD envisions the following for the ensuing four years:

\textsuperscript{42} NPAs reported in this document, presents “Gross NPA”
NABARD’S STRATEGIC FOCUS ON SHG-BLP (2013-17)

➢ All eligible poor rural households in the country to be covered through SHGBLP by March 2017.

➢ Resource poor states of Uttar Pradesh, Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Rajasthan, Maharashtra, Odisha, Assam and West Bengal to be the focus areas for promotional interventions under SHG-BLP during the next four years. Emphasis would be in 127 districts from these resource poor States where less than fifty percent of the potential for promotion of SHGs have been exploited, of which 33 districts are already covered under Women SHG Development Scheme.

➢ Promotion of Women SHGs in 150 Left Wing Extremism affected and backward districts of the country to be speeded up to cover every rural household in the identified districts within the next two years.

➢ In all, it is expected that about 20 lakh new SHGs are to be promoted and linked to the banks during this period.

➢ Convergence with Government Programmes like National Rural Livelihood Mission (NRLM) to maximise benefits to the SHG members.

➢ Strategic shift from State / District-based planning for SHG-BLP to Block-based planning, to address the issue of intra-district imbalances in promotion of SHGs.

➢ Special schemes to revive dormant SHGs through effective capacity building and hand holding support.
➢ Initiate additional financial literacy drive at the SHG level to eliminate over indebtedness at the member-level, especially in high SHG density States.

➢ Focus on convergence of SHG-BLP and Financial Inclusion (FI) initiatives.

➢ Priority to shift from promotion of SHGs to provide livelihood opportunities to the SHG members in a calibrated manner through skill building, production optimization, value chain facilitation and market linkage.

➢ Community based organizations to be encouraged as the nodal points for promoting livelihood activities of members of SHGs.

➢ ICT based interventions at primary level (SHGs), promoting institutional level (SHPIs) and at National level.

**PROGRESS OF SHG-BANK LINKAGE PROGRAMME IN INDIA**

Under the SHG-Bank linkage programme, the coverage of rural households having access to regular savings through SHGs linked to banks came down by around 8% during the year to 95 million as on 31 March 2013. A similar decline of number of SHGs savings linked to Banks was also observed with only 73.18 lakh SHGs linked to Banks as against 79.60 lakh a year back.

Number of SHGs having outstanding credit with banks, however, showed a marginal increase of 2% to 44.5 lakh as against 43.5 lakh the previous year. The average loan outstanding of SHGs with banks is Rs. 88,500 against Rs. 83,500 a year back. There has also been a 6% spurt in...
the number of SHGs getting fresh loans from banks during the year to 12.2 lakh (up from 11.5 lakh the previous year) and the quantum of fresh loans issued also showed a significant growth of about 24% during the year. The share of exclusive women SHGs in the total number of SHGs savings linked to banks now stands at 81% while the groups formed under the SGSY programme now constitutes 28% of the total number of groups. Table-5.1 gives the growth of SHGs - saving as well as credit linked - for the last 3 years, separately for all Groups, Groups formed under SGSY and exclusive Women Groups.

Table 5.1: Overall Progress under SHG-Bank Linkage for last 3 years

<table>
<thead>
<tr>
<th>Particular</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of SHGs (lakh)</td>
<td>Amount</td>
<td>No. of SHGs (lakh)</td>
</tr>
<tr>
<td>SHG Savings with Banks as on 31 March</td>
<td>74.62 (7.3%)</td>
<td>7016.30 (13.2%)</td>
<td>79.60 (6.7%)</td>
</tr>
<tr>
<td>Of which SGSY Groups</td>
<td>20.23 (19.4%)</td>
<td>1817.12 (40.6%)</td>
<td>21.23 (5.0%)</td>
</tr>
<tr>
<td>% of SGSY Groups to Total</td>
<td>27.1</td>
<td>25.9</td>
<td>26.7</td>
</tr>
<tr>
<td>All Women SHGs</td>
<td>60.98 (14.8%)</td>
<td>5298.65 (17.8%)</td>
<td>62.99 (3.3%)</td>
</tr>
<tr>
<td>% of Women Groups to Total</td>
<td>81.7</td>
<td>75.5</td>
<td>79.1</td>
</tr>
<tr>
<td>Loans Disbursed to SHGs during the year</td>
<td>11.96 (-24.6%)</td>
<td>14547.73 (0.01%)</td>
<td>11.48 (-4%)</td>
</tr>
<tr>
<td>Of which SGSY Groups</td>
<td>2.41 (-9.9%)</td>
<td>2480.37 (12.8%)</td>
<td>2.10 (-12.9%)</td>
</tr>
<tr>
<td>% of SGSY Groups to Total</td>
<td>20.1</td>
<td>17.0</td>
<td>18.3</td>
</tr>
</tbody>
</table>
For the first time since the SHG-Bank linkage programme was launched, there is a decline in the number of SHGs savings linked with banks to the extent of 8.1% during the year, though the savings harnessed by SHGs grew by 25.4%. It is evident that this decline is in spite of more number of new SHGs savings linked to banks during the year pointing to existing SHGs gone out of the Banks linkage programme during the year. This decline can be attributed to banks now reporting only operative Savings accounts of SHGs and in few instances of banks closing down accounts with ‘Nil’ balances in SHGs savings accounts. Further, as banks were advised to switch to system generated (core banking solution) reporting only, this has also led to “data cleansing” and more accurate reporting of operative (and not cumulative) SHG accounts. A scrutiny of

![Table]

Source: NABARD, Status of microfinance in India 2012-13
the bank-wise reporting indicates the major decline in reporting by State Bank of India (reduced by 6.35 lakh SHGs, over the previous year). Besides, there has also been gradual decline in the number of SGSY groups savings linked with banks to the extent of 3.6% over the previous year with the gradual switch to NRLM by the Government.

After nearly 3 years, the number of SHGs availing fresh loans by banks showed an increase of 6.3% during the year and the quantum of fresh loans issued increased by 24.5% over the previous year. This is despite the fact that there has been a significant reduction (-16.5%) in the fresh loans issued to SGSY groups. Broadly this is pointer to the fact that Banks are lending more to credible SHGs, providing repeat finances to SHGs with a sound credit history.

**Scheme for Promotion of Women SHGs in backward districts of India**

With the object of scaling up SHG promotion activities in “Left Wing Extremism” (LWE) affected and backward districts in the country, a special initiative was commenced by NABARD with the Govt. of India. The programme entails promoting “Women” Self-help Groups in 150 districts with the assistance of anchor NGOs and support organisations identified for the purpose. The USP of the programme is that the anchor NGOs serves as “Business Facilitators” for banks, promoting, handholding and monitoring the functioning of the SHGs for a fee to be collected from the client. This is expected to ensure continuing interest of the anchor institutions. The agency will also be responsible for repayment of loans by SHGs to banks. The programme also provides for an institutional arrangement by way of Memorandum of understanding (MoU) between an anchor NGO in each of the district and the financing bank to ensure
continuous credit flow. The anchor NGOs are expected to map the potential for promotion of SHGs and attempt to saturate the allocated district with quality WSHGs in a limited time span. This approach is expected to facilitate sustained financial inclusion by extending banking services to women members of SHGs, promote sustainable livelihood opportunities to the members and facilitate effective implementation of other social development programmes for women through SHGs. Already MoU has been entered into by 239 anchor NGOs with the banks, leading to formation and savings linking of 70,000 groups and credit linkage of 18,000 groups with the banks. The overall progress under the scheme is encouraging. NABARD is also supporting the anchor NGOs with capacity building and also promotional grant assistance. During the year 2012-13, an amount of Rs.16.94 crore has been utilised towards promotional grant assistance to anchor NGOs and for training and capacity building of stakeholders from Women SHG Development Fund maintained with NABARD and contributed fully by Government of India.

TRAINING PROGRAMMES

➢ SHG-Bank Linkage Programme (SHG-BLP) – Revisiting the training modules: NABARD has been supporting and organizing training programmes on SHG-BLP for various stakeholders for quite some time. Keeping in view the need for ensuring continued relevance of the training module to the fast changing environment in which the programme operates and to broad base the contents of these programmes for increasing number of stakeholders, NABARD undertook a Comprehensive Training Need Assessment of all stakeholders with the assistance of GIZ (German Technical
Cooperation). The findings of this detailed assessment were deliberated upon with all stakeholders at a National Level Training Consultation Meet on SHG-Bank Linkage training. Based on the deliberations in the meet, a revised Hand Book on Training Module for SHG-BLP stakeholders was prepared, distributed to all stakeholders.

➢ **Exposure programme on “SHG members as BC/BF for FIs”**

Vidarbha Konkan Gramin Bank (VKGB), supported by NABARD, has been successful in effectively leveraging local community members of SHGs to act as Business Facilitators/ Business Correspondents for the Bank to enhance its business and to ensure a sustainable inclusive growth. This model has been recognized as highly successful and scalable by other FIs. NABARD therefore arranged “Exposure Visit to VKGB model” of officials of various Commercial Banks & RRBs. More than 100 officers from Commercial banks and RRBs, were given exposure under this programme during the year.

➢ **Training to Partner NGOs as SHPIs by Resource NGOs**

A number of NGOs engaged in promotion and nurturing of SHGs under SHG-BLP are found lacking in necessary expertise in functioning effectively as SHPIs thereby raising questions on quality and reach in SHG nurturing programme. To address this problem faced by smaller NGOs working as SHPIs under the programme, NABARD has initiated a special short term training (cum attachment) programme for such partner NGOs with resource NGOs at the State level. This programme will focus on practical training on SHG formation and
nurturing by Resource NGOs to the selected volunteers of smaller partner NGOs.

- **Engaging resource NGOs/TEs for training stakeholders in SHG-BLP** : In order to ensure the quality of trainings, instructions have been issued to ensure that only those training organizations having adequate professional trainers and possessing quality training materials be selected as resource NGOs in the States. The financing banks are also being persuaded to organize bank-specific training programmes for their functionaries with the help of these resource trainers.

**CHALLENGES OF MICROFINANCE IN INDIA**

The brief overview of the demand for micro-financial services suggests the huge challenges and the opportunities the Indian market presents. Protective financial services may be critical for poverty alleviation, but they do little for helping people out of poverty. Hence, promotional financial services are required, primarily for enhancing livelihood among poor people. It is said that micro-finance can also harm poor people (Hume and Mosley, 1996). The increase in income of micro-credit borrowers is directly proportional to their starting level of income – the poorer they were to start with, the less is the impact of the loan. Secondly, poor borrowers from Micro-financing organizations often do not graduate to higher and higher loans, and consequently to productive small enterprises. While credit may initially be the ruling constraint for micro enterprises, to grow beyond a certain size, other constraints come into play. Micro-enterprises are therefore unlikely to grow substantially without inputs that can address these additional constraints. Livelihood promotion
is complex, opening up multiple potential goals and interventions and
demanding an understanding of individual household and enterprise as well
as the economic systems or sub-sectors in which they operate. Intervening
in livelihood promotion is far more challenging than developing the
efficient delivery of financial services.

The microfinance industry has, in fact, moved away from livelihood
promotion. Using micro-credit to promote livelihood may not be feasible
with such a strategy. The necessary non-financial services that have to be
added and the investment in understanding the complexity of livelihood
systems entail significant costs. They interventions may also require
engagement with market actors. By 2008, at least one million SHG’s with
17 million members are expected to emerge. As autonomous organization,
SHG’s share the challenges and dynamics of other small organizations.
Forming new groups requires significant energy and the necessary group
Processes. Governments, donors, policy makers and resource providers
need to be aware of the dynamics involved in these small organizations.
The institutional challenges in micro financing are three fold:

(i) How to support existing leading and social entrepreneurs and nurture
    new ones; at least one million SHG’s will be require support;

(ii) How to ensure the SHG’s remained autonomous and are not captured
    by political and bureaucratic interests pursuing votes or targets? Will
    the emerging movement of SHG’s be any better at preventing this
    than previous movements, such as cooperatives?

(iii) How to support the SHG’s movement so that it can go beyond
     financial service provision to support the development of a large
     number of livelihoods among SHG members? Some would argue,
this is inappropriate for such small organizations. Other, would say it is essential given the livelihood India needs to generate, not the least for women?

As for credit, its usage among poor households in 1998 was estimated to be almost $11 billion. It is clear from the rapid growth of Self-help groups and other community based intermediaries that if credit were more readily available, its usage would only go up, suggesting that much demand for credit among poor households is also not met. Further, the supply of insurance services to poor people is increasing, including low premium schemes, covering death, accidents, natural calamities, loss of assets etc. However, poor people face significant risks in purchasing insurance. Moreover, the total current demand for micro-financial services is not being met and there is likely to be significant additional latest demand. In addition, demand needs to be enhanced by supporting the growth of micro-producers and community based organizations that will enhance their need and capacity for absorbing credit, as well as other financial services.

The total outreach of specialized providers of micro-financial services is estimated to fall over-below one percent of credit usage by poor households. While banks have given a very large number of small loans, the proportion of rural credit usage supplied by the formal sector stood at 56.6 percent in 1991 and it is much lower for the poorest households. Banks have not delivered effective micro-financial services, but they have been driven by mandatory targets and subsidies resulting in low repayment rates, leading to a vicious cycle of non-availability and non-repayment
(Mahajan and Nagasri, 1999). Non-profit micro financial organizations face the following constraints (Matthew Titus, 2002):

i. In most states, the Registrar of Societies has not recognized microfinance as a permitted activity for societies (NGO’s).

ii. The Income Tax Act [Section 2(15)] does not define microfinance as a charitable activity, so that NGO’s engaged in microfinance risk losing their charitable status.

iii. The Income Tax Act [Section 11(5)] does not allow NGO’s to promote mutual benefit or commercial micro-financial organizations, as they are not allowed to invest in equity.

iv. The Foreign Contribution Regulation Act is ambiguous about receiving funds for microfinance, whether the foreign funds are used as grants or loans.

v. Non-profit micro-financial organizations have difficulty raising deposits without contravening the Reserve Bank of India Act.

With massive expansion, the performance of SHG’s also becomes even more critical, especially as many SHG’s are being promoted by governments and banks. Ensuring good performance and sustainability across such a vast number of small local organizations is a real challenge and will require significant resources for support and development. Moreover, as specialized micro-financial organization grow, whether NGO’s, cooperatives or companies, they will require increasing resources not just for capital but also for organizational and human resource development to ensure their becoming become effective financial and developmental organizations. Another challenge is that the vast majority of resources are channeled through public agencies, which can be slow, rule
bound and risk averse. Almost no attempt has been made to build more independent organizations for resourcing and supporting providers of micro-financial services that must emerge if the sector is going to massively expand and develop.

KEY ISSUES IN MICROFINANCE IN INDIA

Loan Default: Loan default is an issue that creates a problem in growth and expansion of the organization because around 73% loan default is identified in MFIs. Lack of understanding on the part of the clients, they also cannot correctly manage the loans given to them. As a result, they are not able to pay back the loan.

Low Outreach: In India, MFI outreach is very low. It is only 8% as compared to 65% in Bangladesh. Data show the great potential of MFIs in increasing their outreach and scale of operations. It has been observed that MF programmes focus a great deal of attention on women. It has been argued that women are better clients as they are more inclined to save than men, they borrow smaller amounts than men and their repayment performance is better than men. These characteristics of women clients constitute evidence in support of the inclination of MFIs to cater to the needs of women. Women may be better and more reliable clients, but in order to increase their outreach MFIs cannot ignore men as clients.

High Interest Rate: MFIs are charging very high interest rates, which the poor find difficult to pay. It has been argued that MFIs are private entities and hence need to be financially sustainable. They do not receive any subsidized credit for their lending activities and that is why they need to recover their operational costs from borrowers. In the process, the basic
reason for their existence-and their primary objective-is being lost. It is important that these NGOs should be willing to operate at narrow margins and to bear a low effective interest rate so that they can maintain a balance between their dual objectives of commercial viability and serving the poor.

**Negligence of Urban Poor:** It has been noted that MFIs pay more attention to rural areas and largely neglect the urban poor. Out of more than 800 MFIs across India, only six are currently focusing their attention on the urban poor. However, the population of the urban poor is quite large, amounting to more than 100 million. With increasing urbanization, this number is expected to rise rapidly in the coming years. In this situation, MFIs need to pay equal attention to the urban poor because they too need financial assistance for various activities.

**Client Retention:** Client retention is an issue that creates a problem in growing the MFIs. There is about 28% client retention in the MFIs. This occurs because people are not properly informed and educated about services and products provided by the institutions more over the current client have higher default rate.

**Low Education Level:** The level of education of the clients is low, so it creates a problem in the growth and expansion of the organization because its percentage is around 70% in MFIs. Target population of MFIs is people of rural areas and they have no or less education level. As the percentage of people who have very less education.

**Language Barrier:** Language barrier makes communication with the clients (verbal and written) is an issue that creates a problem in growth and expansion of the organization because around 54% language barrier has
been identified in MFIs. As the education level of clients is low so it is difficult to communicate with them. For this reason it is also difficult for the MFIs employees to make the clients to understand the policy and related details.

**Late Payments**: Late payments are an issue that creates a problem in growth and expansion of the organization because late payments are around 70% in MFIs. This usually occurs because clients are uneducated and they don’t know how to manage their debt. They are unaware of the fact that late payment increases their loan payments.

**Geographic Factors**: Around 60% of MFIs agrees that the Geographic factors make it difficult to communicate with clients of far-flung areas which create a problem in growth and expansion of the organization. MFIs are basically aimed to facilitate the BPL population of the country but due to lack of infrastructure in those areas it becomes difficult to reach them.

**Debt Management**: Clients are uneducated about debt management 70% of the clients in MFIs are unaware of the fact that how to manage their debt. Because of the lack of education and understanding on the part of the clients, they also cannot correctly manage the loans given to them. So for this reason debt management creates a problem in growth and expansion of the organization.

**High Transaction Cost**: High transaction cost is a big challenge for microfinance institution. The volume of transactions is very small, whereas the fixed cost of those transactions is very high. It cannot vary with the size of the loan. The higher a producer’s fixed costs in the proportion of his total cost, the element of risk increases in the same proportion. Moreover,
if the demand for the product falls or the marginal costs increases, it becomes very difficult to adjust the cost by cutting output. This cut will reduce revenue out of which he has to pay principal amount as well as interest on the loan. This needs to be rationalized.

**Lack of access to Funding**: Another factor contributing to the lack of growth in MFIs is that requisite financial support has not been provided to MFIs by concerned agencies. Around 68% of MFIs response was in favour of that government and SBP don’t support them to meet the funds requirement as MFIs cannot alone remove the poverty from the country.

**Loan Collection Method**: Loan Collection Method is found an issue that creates a problem in growing the organization. Around 55% of MFIs agrees that due to weak law and legislation they are not able to make their loan collection system as effective as they want to do so.

**Fraud**: Fraud is an issue that creates a problem in growth and expansion of the organization because its percentage is around 67% in MFIs. Mis-management of loans on the part of the clients creates the problem of fraud and financial embezzlement on the part of clients.

**Increased Competition**: Increased competition is an issue that creates a problem in growth and expansion of the organization because its percentage is around 72%. As there has been growth in the banking sector with regard to the loan facilities therefore, there is a greater competition among such institutions.

**Uneven Population Density**: Uneven population density is an issue which create problem in growth and expansion of the organization because loans and funds are required by rural population not urban areas.
Challenges before the MFIs: No doubt, microfinance programme has shown impressive achievements, but a number of challenges are there:

- Did this programme reach the underprivileged?
- Whether everyone in need of microfinance intervention had been reached by any of the agencies?
- Even if everyone had been reached, did they get the required quantum of assistance to have sustainability?

These questions are still very inconvenient to be answered because there are certain challenges associated with this programme. Some of the main challenges have been discussed in the following manner:

Quality of SHGs: The third challenge is how to ensure the quality of MFIs in an environment of exponential growth. Due to the fast growth of the SHG-Bank Linkage Programme, the quality of MFIs has come under stress. This is reflected particularly in indicators, such as the poor maintenance of books and accounts etc. The deterioration in the quality of MFIs is explained by a variety of factors including: The intrusive involvement of government departments in promoting groups; inadequate long-term incentives to NGOs for nurturing them on a sustainable basis; and diminishing skill sets on part of the MFIs members in managing their groups. In my assessment, significant financial investment and technical support is required for meeting this challenge.

Regional Disparity: It has been observed that the microfinance programme is mainly run by formal financial institutions with the help of SHGs. As a result, microfinance programme is progressing in those areas of the country where there is tremendous growth of formal financial
institutions. Microfinance institutions were expected to reach those areas where the formal banking system failed to reach and the poor people have to depend on the moneylenders in order to meet their financial requirements. But, actually many big MFIs are activating in those states where the banking network is very strong. In the southern states, such as Andhra Pradesh, Tamil Nadu, Karnataka and Kerala, the spread of SHG bank linkage programme as well as the MFI programme is very large. However, the north and north-eastern region is almost neglected. In the southern India the spread of commercial bank branch network is the highest (27.94 percent) and these states cover 48.15 percent of the country’s total SHG members and 54.77 percent of the MFI members. So, approximately 50 percent of the total microfinance programme beneficiaries belong to these four south Indian states. In contrast to this, in the north-eastern region of India, bank branch network is very limited and the coverage of microfinance programme is just 2.93 percent. The table also shows the region-wise branch network and the microfinance members covered under SHG-Bank Linkage and MFI model in these different regions.

Deserving Poor are Still not Reached : The microfinance delivery models are not exclusively focused on those who are below the poverty line or very poor. Though, the programme is spreading rapidly but with a slow progress in targeting the bottom poor households. About 50 percent of SHG members and only 30 percent of MFI members are estimated to be below the poverty line. According to Ghate (2008), approximately 75 million households in India are poor and about 22 percent of these poor households are currently receiving microfinance services. In order to run the groups
successively and to achieve higher repayment rates, they generally select the non-poor people as programme beneficiaries. The study finds that the core poor are often not accepted in group lending programmes by other group members because they are seen as a bad credit risk.

In spite of the various institutional barriers, various psychological problems relating to the poor people restrict them to join the programme. The extreme poor often lack self-confidence so they hesitate to join a group where they have to deal with the other group members, bank officials and other promoting institutions. The core poor are generally too risk averse to borrow for investment in the future. They will therefore benefit only to a very limited extent from microfinance schemes.

**Microfinance Outreach in Seven Poorest States of India :** Unfortunately, these seven states, Orissa, Bihar, Chhattisgarh, Jharkhand, Uttarakhand, Madhya Pradesh and Uttar Pradesh are lagging behind in microfinance programme. These states hold approximately 53.5% of the total poor in India and the share of these seven states is just 23.60% of total microfinance outreach in India. The reasons for this skewed distribution of microfinance programme may be the intense support extended by the state governments, local culture and practice and concentration of MFIs.

**Low Depth of Outreach :** Another problem faced by the microfinance programme is the depth of services provided. Though the outreach of the programme is expanding, large number of people is provided with microfinance services but the amount of loans is very small. The average loans per member in both MFIs and SHGs are between Rs. 3,500. This amount is not sufficient to fulfill the financial needs of the poor people.
The duration of the loans is also short. The small loan size and short duration do not enable most borrowers to invest it for productive purposes. They, generally, utilise these small loans to ease their liquidity problems.

**Unregulated Microfinance Institutions**: In India, microfinance is provided by a variety of institutions. These include banks (including commercial banks, RRBs and co-operative banks), primary agricultural credit societies and MFIs that include NBFCs, Section-25 companies, trusts and societies. But only the banks and NBFCs fall under the regulatory purview of the Reserve Bank of India. Other entities, e.g. MFIs are covered in varying degrees of regulation under their respective State legislations. There is no single regulator for this sector. As a result, MFIs are not required to follow some standard rules and are not subject to minimum capital requirements and prudential norms. This has weakened their management and governance, as they do not feel it mandatory to adopt some specific systems, procedures and standards. Therefore, there is a need for regulating the varied number of microfinance providers, which are influencing the lives of millions of poor people. The regulation would, therefore, help in improving the growth of MFIs in an orderly approach.

**Lack of Insurance Services**: Poor people are vulnerable to financial shocks. A small change in their earning patterns due to natural calamities, health problems, death of earning member etc. can push them to destitute. So, a provision of insurance under the microfinance programme is very essential to help the poor to cross the poverty line. But, in reality, the current microfinance programme in India is just focused on regular saving and micro-credit. SHG-BLP developed by NABARD is also providing saving and credit services mainly and the provision of insurance is very
less. However, some of the MFIs have started providing insurance services but the efforts are still at an experimental stage. Therefore, in India, the provision of insurance services is at the initial stage and this integral part of the microfinance programme is still neglected.

On the above findings it is observed that so many problems are associated with the MFIs. The Microfinance institutions are lagging behind in terms of loan and credit to the real needy, regional imbalance, a proper regulation etc. Internal, external and client based challenges are prevailing from starting of the MFIs in India.